

#ClosingTheGap Mekong

Country Report

Lao PDR

Entrepreneurial Ecosystem Assessment



Commissioned on behalf of:
Dutch Good Growth Fund (DGGF): Investment funds local SMEs
April 2019

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The Dutch Good Growth Fund, part Investment funds for local Small and Medium Enterprises (SMEs), is a “fund of funds” investment initiative from the Dutch Ministry of Foreign Affairs. The initiative aims to improve financing for the “missing middle” – i.e. entrepreneurs who have outgrown micro-finance but do not yet have access to regular financial services. The Seed Capital and Business Development (SC&BD) program was established to increase the impact of the DGGF by providing technical assistance, seed capital and business support services to intermediary investment funds and local SMEs. The program incorporates a knowledge development and sharing component that supports research, tests assumptions and shares insights into financing SMEs in developing countries and emerging markets - fostering industrywide knowledge exchange.

Authored by:

Matt van Roosmalen, Latdamone Phodsavang, Emerging Markets Consulting (EMC)

Reviewed by:

Dominic Mellor, Asian Development Bank

Timo Hogenhout, Consultant Financial Inclusion / Access to Finance in Southeast Asia

Marnix Mulder, Director Market Development, Triple Jump

Coordinated by:

Triple Jump, fund manager of Dutch Good Growth Fund (DGGF) part Investment funds local SMEs:

Julia Kho, Knowledge Manager

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Design & Visuals:

Julian Deleij, De Beeldmaecker

Disclaimer:

#ClosingTheGap Lao PDR has been commissioned on behalf of DGGF as part of the #ClosingTheGap series of entrepreneurial ecosystem assessments. The findings and recommendations are at the discretion of the consultants – Emerging Markets Consulting - and do not necessarily reflect the opinion of DGGF and/or its partners.



Ministry of Foreign Affairs



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Abbreviations

ANDE	Aspen Network of Development Entrepreneurs
APB	Agricultural Promotion Bank
BCEL	Banque Pour Le Commerce Exterieur Lao
DFI	Development Finance Institutions
DGGF	Dutch Good Growth Fund
EMIA	Emerging Markets Investment Advisors
FDI	Foreign Direct Investment
GoL	Government of Lao PDR
IFC	International Finance Corporation
LDB	Lao Development Bank
LDC	Least Developed Country
LLDC	Landlocked Developing Country
LNMC	Lao National Marketing and Coordination Office
LNCCI	Lao National Chamber of Commerce and Industry
LSX	Lao Securities Exchange
MBI	Mekong Business Initiative
MGB	Moderate-Growth Businesses
MIST	Mekong Innovative Startup Tourism
MOIC	Ministry of Industry and Commerce
MOF	Ministry of Finance
NE	Necessity Entrepreneurs
SCBD	Seed Capital and Business Development
SGB	Small and Growing Businesses
SHB	Small High-Growth Businesses
SNE	Successful Necessity Entrepreneurs
SME	Small and Medium Enterprise
TVET	Technical and Vocational Training
WBES	World Bank Enterprise Survey
WEC	Women's Entrepreneurial Center

Executive Summary

Lao PDR is the smallest country in the #CTGMekong series, with only about 7 million people (2017), and a landlocked economy reliant on extractive and hydropower industries. As a socialist republic, the government has a significant impact on the economy. The business landscape therefore consists of a few large firms in a relatively small number of industries, and numerous small and micro businesses in both urban and rural areas that remain largely informal.

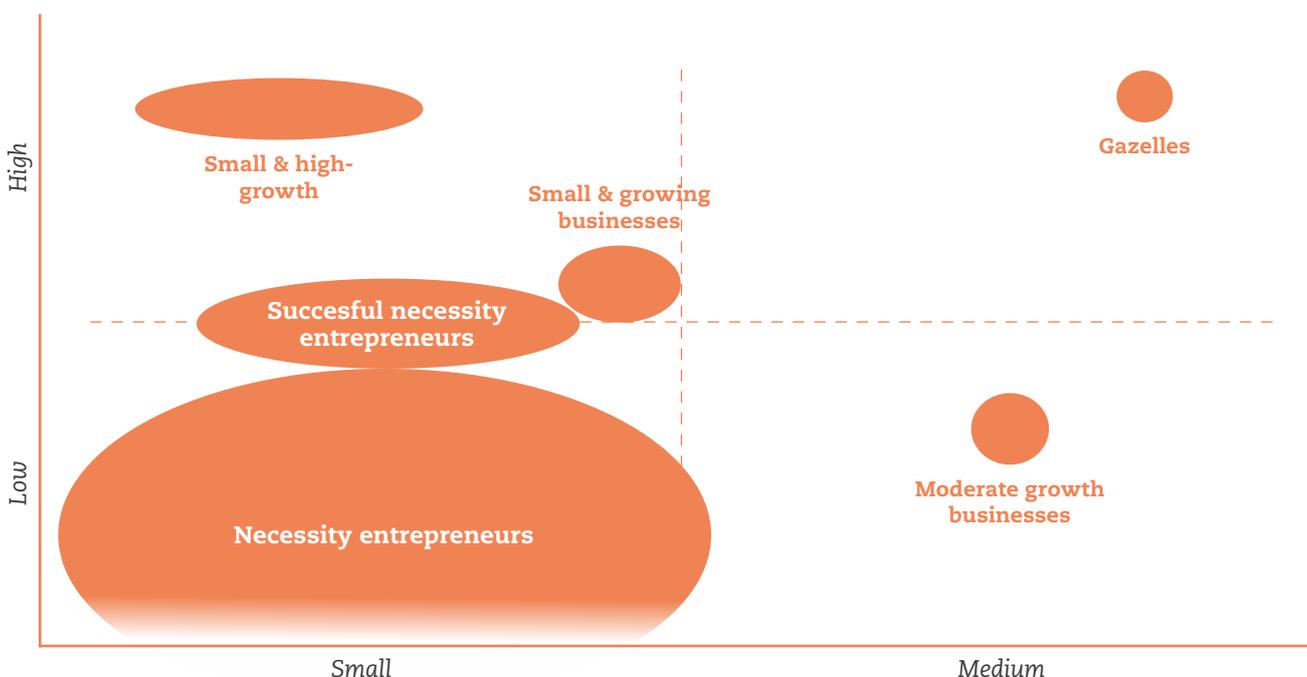
Recognizing this imbalance, the Government of Lao PDR (GoL) has begun a series of reforms to support growth and formalisation of small and medium-sized enterprises (SMEs). This includes enterprises in the “missing middle”: those that have outgrown microfinance but are not yet covered by commercial bank financing. These enterprises are important for the diversification of the Lao economy, employment generation and poverty reduction. In the last few years especially, young Laotians have increasingly discovered entrepreneurship and seized opportunities for startups in Lao PDR, following success stories observed throughout the region.

However, segmentation of the World Bank Enterprise Survey (WBES) from 2016 still shows that even the vast majority of registered firms is small and growing slowly. More than two-thirds of such establishments employ fewer than 20 people, and experience levels of revenue growth at or below 10%. In contrast, the number of SMEs that are large and growing quickly (Gazelles) represent only 1% of all enterprises. The future of Lao PDR’s entrepreneurial ecosystem rests on those smaller enterprises that have managed to achieve growth rates exceeding 10%, and they will need support services and finance to become the next Gazelles.

Most SMEs Are Small and Not Growing

As shown in the WBES, most registered enterprises are small and barely growing. Based on older surveys and anecdotal evidence, informal microbusinesses make up an even larger share of total establishments. Only few enterprises in Lao PDR are large or growing quickly.

Figure 1: Sub-segments as proportion of total



Source: EMC analysis based on the 2016 Enterprise Survey (<http://www.enterprisesurveys.org>), The World Bank

¹ World Economic Forum Classification

There are three main reasons for this. First, the market is relatively small and entrepreneurs seeking rapid growth need to establish a market in all urban areas and even abroad. Second, an unfavorable business climate with little support for formalisation encourages firms to stay informal to avoid regulatory requirements and tax payments, which is demonstrated by firms surveyed in the WBES reporting unfair competitive practices in the informal sector as the single largest entrepreneurial constraint. Third, this informality hinders businesses from obtaining funding to invest in innovation, limiting Lao business strategies to copying the region's proven models and thus inheriting fierce competition and low margins. As a result, the majority of SMEs have similar business models and compete heavily in sub-national markets, without much differentiation due to lack of managerial experience and funding.

Access to Finance Is a Growing Concern

Lack of service providers to instill the required financial literacy and business planning skills that attract growth finance was identified as the main gap by interviewed entrepreneurs. This includes the complex procedures to register with different line ministries and obtain permits, as well as approach banks for financing. Lao entrepreneurs, especially young startups, are far behind their regional peers in obtaining bank financing.

This issue is compounded by high cost of finance, introduced by regulatory restrictions on borrowing and lending in different currencies. Most SMEs requiring investment capital would seek a longer tenor than is currently available, due to systemic country and currency risks as well as an unpredictable central bank and lack of credit bureau to cover firm debt and individual debt, which is the primary funding source for unregistered enterprises.

There is also a noticeable lack of risk capital in Lao PDR, due to a lack of corporate venturing as well as minimal attention from regional venture capital and private equity funds. Some angel investors are active in the country, but they are not organised in a formal network such as in Vietnam, and most entrepreneurs therefore rely on seed financing from family and friends.

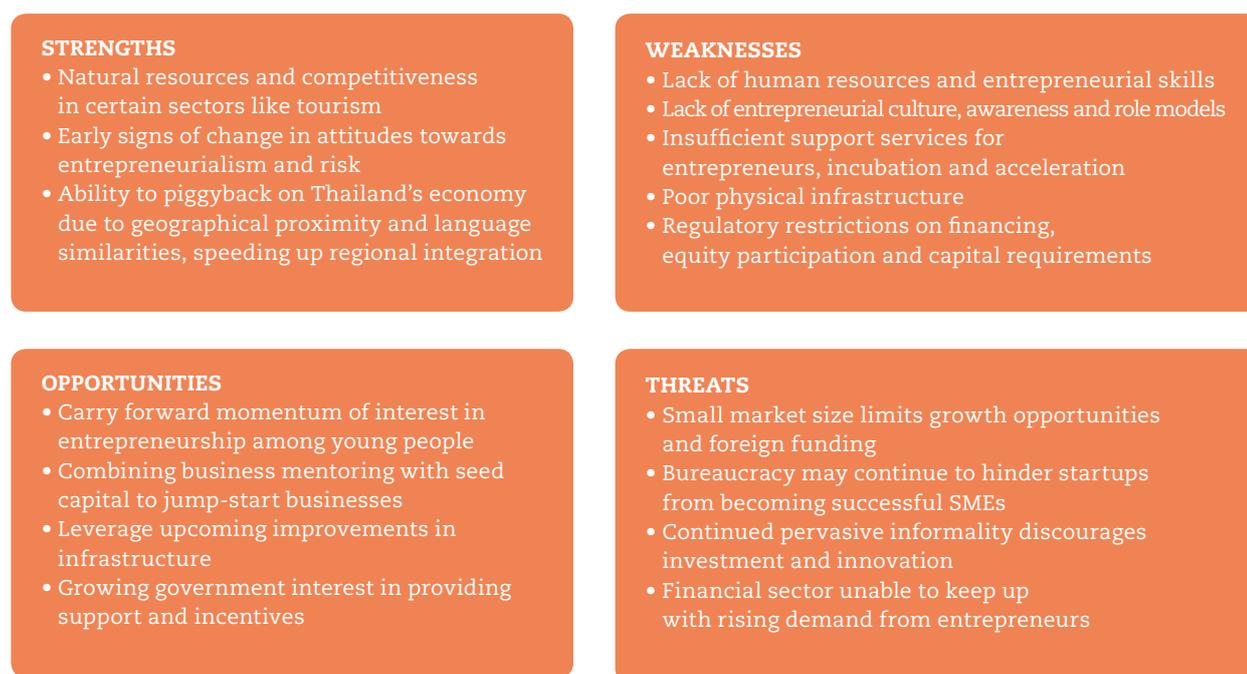
Business Support Services Are Nascent and in Need of Resources

Even more so than other countries in the #CTGMekong series, Lao PDR lacks a vibrant and dynamic ecosystem of business support service providers. While there are a few co-working spaces and business associations organising events, tailored coaching and support is lacking. The entrepreneurs that have successfully accessed these services tend to be well connected with the handful of ecosystem builders that do exist.

What became clear – both during the workshop as well as interviews with entrepreneurs reflecting on the early stages of their ventures – is that startup culture must be promoted within the Lao educational system and society.

Entrepreneurs expressed the need for role models or 'champions' to follow, as well as a space to share experiences with other entrepreneurs either in success or failure. During the #CTG workshop in Vientiane, the overwhelming response from the participants was a desire to have more of these workshops, where they can exchange ideas and boost enthusiasm for entrepreneurship. If the current ecosystem builders and co-working spaces are properly supported to host even such basic events, they could develop a pool of mentors that would allow the next generation of entrepreneurs to engage in more personalised and detailed coaching.

Figure 2: SWOT analysis of the Lao PDR ecosystem



Recommendations

In addition to implementing a pro-business, regulatory reform agenda that makes it easier to formalise businesses and integrate regionally, we recommend two opportunities to further SME growth: increase awareness and access to basic services for aspiring entrepreneurs and provide tailored financial offerings to complement these services. It is imperative to recognise the need for skill development amongst these aspiring entrepreneurs, as well as the nascent business support services and financial offers.

Crucially, the most successful entrepreneurs will need to work with financiers and support providers to export their products and services, overcome the inherent limits of Lao PDR's small market, or focus on profitable niche areas with high value-added such as tourism or organic agricultural products.

The first step in developing the entrepreneurial ecosystem is to raise awareness among aspiring entrepreneurs, and establish learning platforms through workshops and events, preferably introducing experience from the wealth of entrepreneurial experience in the region. Lao entrepreneurs lack visible role models, which inhibits support from their immediate environment including family. More attention to entrepreneurship in education as well as the media will help overcome this information gap, and even simple events such as information-sharing of failures and successes can have a major impact in inspiring the next generation of entrepreneurs.

A first step would be to empower existing ecosystem players, such as co-working spaces, to organise trainings and workshops and facilitate experience exchanges. This could then develop into a network of coaches and even angel investors, following examples shown in Vietnam.

Once entrepreneurs have the capacity to develop solid business plans, banks and other financial institutions need to work together with donors and the financial regulator to increase access to investment and working capital financing. The regulator and government in particular play a critical role in incentivising entrepreneurs to invest in research and development as well as business models that can take advantage of regional opportunities, without the burden of onerous documentary requirements.

1. Introduction

The business landscape in Lao PDR consists of a few large firms in a relatively small number of industries, with many small and micro businesses in both urban and rural areas that remain largely informal. The Government of Lao PDR (GoL) has begun a series of reforms to support growth and formalisation of small and medium-sized enterprises (SMEs). This includes enterprises in the “missing middle”: those that have outgrown microfinance but are not yet covered by commercial bank financing. These enterprises are important for the diversification of the Lao economy, employment generation and poverty reduction. In the last few years especially, young Laotians have increasingly discovered entrepreneurship and seized opportunities for startups in Lao PDR, following the success stories they have seen throughout the region.

In this context, the Dutch Good Growth Fund (DGGF) undertook a diagnostic study of the Lao PDR entrepreneurial ecosystem with a deeper evaluation of the financial offering available for SMEs.

1.1 Objective

This study has been conducted on behalf of the DGGF, an initiative of the Dutch Ministry of Foreign Affairs. The DGGF is a “fund of funds” investment initiative of the Dutch Ministry of Foreign Affairs that aims to improve access to finance for the missing middle – that is, entrepreneurs who have outgrown microfinancing but do not yet have access to conventional financial services.

The Seed Capital and Business Development (SCBD) Facility was established to further the impact of the DGGF by providing technical assistance, seed capital and business support services to intermediary funds and local SMEs. In addition, the program incorporates a knowledge-sharing component that supports research, tests assumptions and shares insights on financing SMEs in developing countries and emerging markets and fosters industry-wide knowledge exchange.

Under the SCBD knowledge development and sharing component, the DGGF #ClosingTheGap series aims to improve the common understanding of key challenges faced by entrepreneurs and especially the “missing middle” in countries covered by the DGGF mandate. The #CTG series is a tool to facilitate and support local and international stakeholders’ efforts to set the agenda for SME development. Working together, local stakeholders and their international partners should be better able to identify solutions to the main gaps in entrepreneurial ecosystems that hamper the growth of local enterprises.

The study was commissioned to gain a better understanding of the ‘missing middle’ in the Mekong region of Southeast Asia, of which Lao PDR is one of the focus countries. The report describes the main factors that hamper SME growth and suggests possible actions to address them.

Figure 3: ANDE framework and entrepreneur capabilities



1.2 Approach

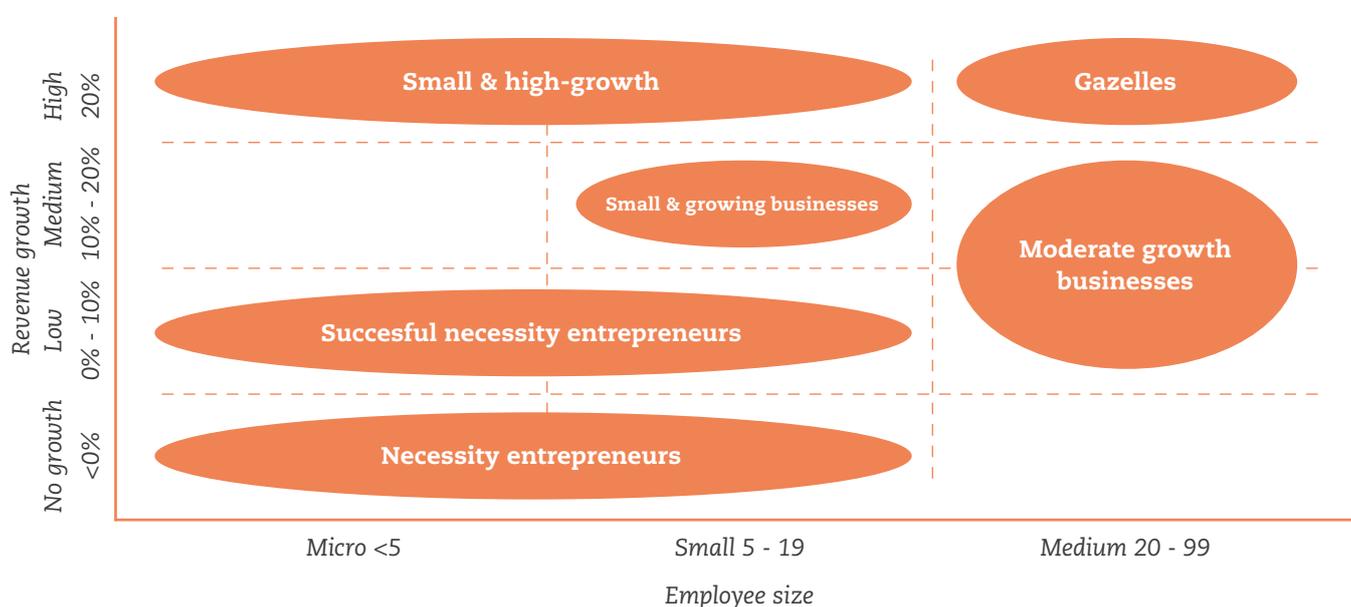
DGGF #ClosingTheGap series was designed to improve the common understanding of key challenges faced by the “missing middle” by researching local entrepreneurs’ characteristics and needs; testing assumptions related to the current financial and non-financial service offerings and sharing insights as to their impact on the conduciveness of the ecosystem overall. The methodology was piloted in Kenya in 2015 and scaled to a regional level in francophone West Africa in 2017 using the Aspen Network of Development Entrepreneurs’ (ANDE) framework for ecosystem assessment.¹ The framework was modified for #ClosingTheGap Mekong by adding entrepreneurs’ capabilities at the centre of it.

Figure 4: Description of entrepreneurs’ capabilities

ENTREPRENEUR CAPABILITIES	DESCRIPTION
Strategic planning	Short and long-term planning of products and services to be offered, local and international expansion plans, generating new business models, business restructuring, and exit strategies
Market & environment related	Engagement with potential customers and end users to gain an understanding of unmet market and societal needs. Market intelligence and management of distribution channels
Generating & testing products	Generating new products or services and testing them in the market
Acquiring finance	Acquiring and raising finance in order to expand businesses
Business operation	Financial management, value chain management, staff management and other operational management
Acquiring & retaining human resource	Acquiring and retaining human resources in order to expand businesses
Networking	Networking and partnering with other individuals and organisations

To identify groups of SMEs according to growth and size characteristics, we used the World Bank Enterprise Survey 2016 (WBES) classifications, as described in the following figure. WBES data covers 139 countries, including all countries in the #CTGMekong, and therefore provides a good basis for inter-country comparisons.

Figure 5: Segmentation framework



¹ Entrepreneurial Ecosystem Diagnostic Toolkit, Aspen Network of Development Entrepreneurs, Dec 2013.

The Lao PDR WBES 2016 only includes registered establishments and excludes micro firms with fewer than five employees, so authors cannot incorporate microbusinesses into the segmentation. Also, while the survey includes data relating to gender of majority owner and top management, it excludes data on their ages, so it is not possible to segment for ‘young entrepreneurs’, aged 18-35.

Therefore, the research also draws on an extensive literature review, as well as key informant interviews (KIIs) with entrepreneurs and service providers in the ecosystem, including those in the informal economy. Please see Annex 2 for a more detailed note on the methodology, with regards to the use of WBES data.

In July 2018, a workshop brought those stakeholders together in Vientiane to review, validate and challenge current research findings and engage in an interactive session in order to elaborate solutions that can address gaps identified in the ecosystem. Participating groups were asked to comment on ‘entrepreneur personas’² that typified businesses and growth challenges faced by firms in each sub-segment, identify gaps and propose solutions. Conclusions from the workshop are directly captured in this report.

BACKGROUND

- TradeCraft sells high-quality traditional handicrafts, primarily to tourists from western countries
- The current manager took over the family business from her parents, inheriting minimal cash reserves and an existing \$1,500 MFI loan

AMBITIONS

- Grow the business by expanding to multiple locations and distribution channels to increase sales

CHALLENGES

- Lack of market knowledge and access
- Lack of business planning skills
- Financing options exhausted

Small growing business

2. Overview of Lao PDR

In the last fifteen years, Lao PDR has achieved significant economic growth and poverty reduction from a very low starting point. Between 2011 and 2015, annual economic growth averaged 7.9%, while inflation remained moderate and the fiscal deficit also steady at 5% of GDP. A number of factors underlie Lao PDR’s high growth performance in recent years. These include the heavy reliance on the natural resource sector as the main engine of growth – including investment in hydropower and mining – as well as significant domestic spending on construction activities and expansion of the services sector. Strong demand for its hydroelectric and mining exports, as well as the relatively rapid growth of neighbouring countries, also helped sustain Lao PDR’s own advancement. FDI in Lao PDR is dominated by three of its largest neighbours: China, Thailand and Vietnam, which accounted for almost three quarters of all approved FDI projects in 1989-2015.³ They also represent Lao PDR’s main trading partners.

LAO PEOPLE’S DEMOCRATIC REPUBLIC

AREA 236,800 sq km
 POPULATION 6.858 million (2017 est.)
 CAPITAL Vientiane
 OTHER MAIN CITIES Luang Prabang, Champasak
 OFFICIAL LANGUAGE Lao
 CURRENCY Lao Kip (LAK)
 GDP PER CAPITA US\$ 2,357 (2017)
 DOING BUSINESS INDEX 154 (2019)

Sources: World Bank 2017; 2018

² See Annex 1 for the personas used.

³ OECD Investment Policy Reviews: Lao PDR (2017)

Figure 6: Regional comparison of population and GDP

COUNTRY	POPULATION (MILLIONS)	GDP NOMINAL (US\$, BILLIONS)	GDP PER CAPITA (US\$)	GDP GROWTH 2012 – 2017 (AVG. % PA)	CLMV TRADE (% TOTAL TRADE) ⁴
Vietnam	95M	241.4	2,552	6.2%	1.2%
Myanmar	53M	67.3	1,279	7.2%	1.7%
Cambodia	16M	24.1	1,485	7.1%	7.5%
Lao PDR	7M	18.2	2,690	7.4%	8.2%
Total	170M	355.3			

Source: World Bank 2017

While poverty rates have declined significantly – 33.5% in 2003, 27.6% in 2008, and 23.2% in 2013, and to approximately 20% in 2015, based on the national poverty line⁵ – Lao PDR remains one of the poorest countries in Asia.

With Lao PDR being a landlocked and sparsely populated country at 6.9 million, – albeit surrounded by some of the region’s most rapidly growing economies – the nation’s strategy of producing low value-added goods primarily for export and relying on unskilled labor has fallen short of reducing poverty and promoting broad prosperity. Nevertheless, given its small domestic market, Lao PDR will need to take full advantage of opportunities to integrate more fully into regional and global economies.

3. SME Landscape

The private sector in the Lao PDR is highly fragmented. Official figures for registered enterprises show that small enterprises (up to 19 employees) comprise about 99% of all enterprises in Lao PDR. The country has only about 1,100 medium-sized enterprises (20-99 employees) and 200 large enterprises (100 or more employees). While developing countries commonly count small firms as the majority within their ecosystems, the proportion of small firms to all others in Lao PDR puts the country at the higher end of the spectrum.⁶

Not only are most registered firms in Lao PDR small, they tend to stay small. Based on enterprise surveys conducted by GIZ in 2011 and 2013 (the most recent panel data available)⁷, only 6% of small enterprises surveyed in 2011 had grown into medium-sized or large enterprises by 2013. Similarly, only 2% of the medium-sized enterprises surveyed in 2011 had grown into large enterprises by 2013, while 46% actually shrunk to small enterprises over the same period.

These statistics highlight a key challenge for private sector development in Lao PDR: small firms have difficulty both growing into larger firms and achieving the scale necessary to improve their productivity and access to international markets. The ecosystem will need to be strengthened along several key pillars to enable entrepreneurs to grow their businesses.

Segmentation based on the latest WBES confirms the previous statistics, with the clear majority of firms being small and growing slowly, or not at all. Only 3% of firms are of medium size, and only 1% can be categorized as Gazelles, or larger, high-growth companies.

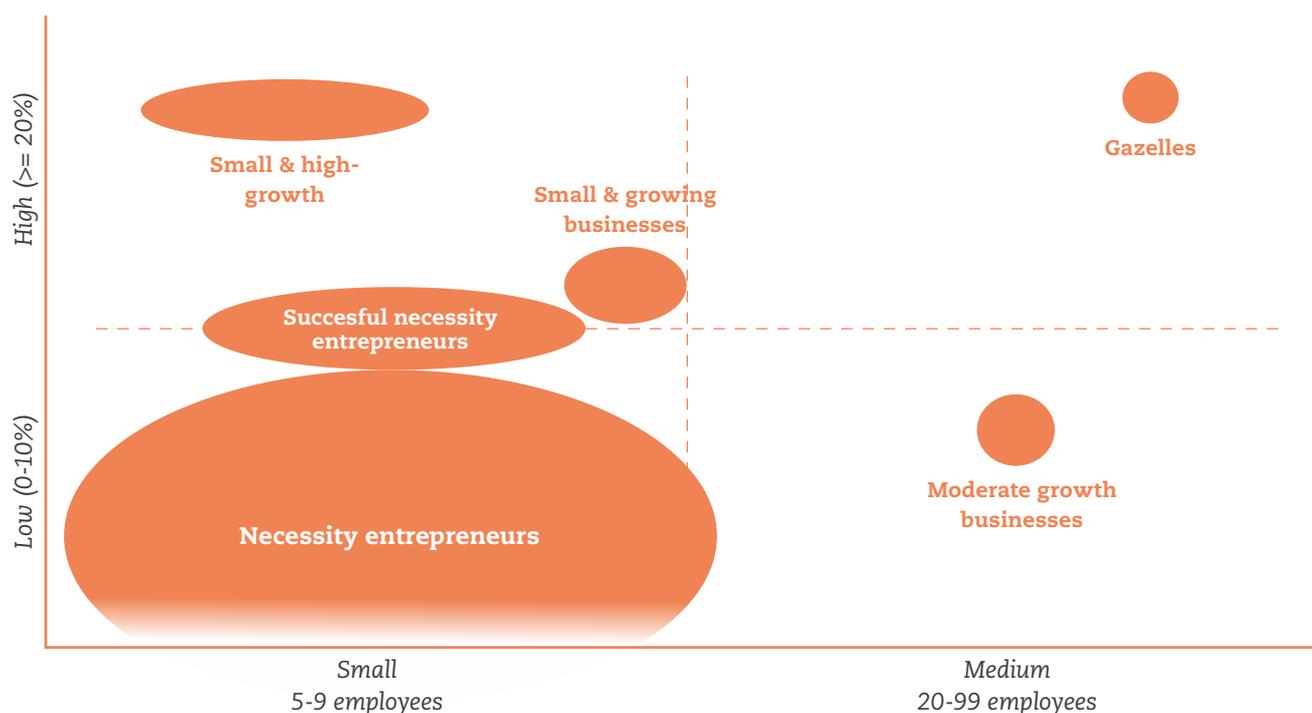
⁴ Imports from CLMV + Exports to CLMV / (Total Imports + Total Exports

⁵ ADB, Country Partnership Strategy Lao People’s Democratic Republic, 2017–2020: More Inclusive and Sustainable Economic Growth, August 2017

⁶ Mekong Business Initiative, Business Formalization in the Lao PDR, 2017

⁷ GIZ, HRDME Enterprise Survey 2013 for Lao PDR, Vientiane, July 2014

Figure 7: Sub-segments as proportion of total



Source: EMC analysis based on Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank

- **Necessity entrepreneurs (NE)** constitute the largest group within the SME sector. They are small businesses that experience low or negative annual turnover (no growth). In Lao PDR, such firms employ an average of 7.3 full-time employees. They are located across the country, as with all small-sized segments. They are predominantly in services and retail, with some manufacturing.
- **Successful necessity entrepreneurs (SNE)** are small businesses in the SME sector that experience low growth in annual turnover (0-10%). They employ an average of 7.8 full-time employees and are more likely to increase that figure to ten, compared with necessity entrepreneurs. Like NEs they are mostly in services, but more likely to be in manufacturing.
- **Small and growing businesses (SGB)** are characterised by moderate annual turnover growth (10-20%), employ an average of 10.6 full-time employees and are less likely than SNEs to employ more than ten. They are almost equally likely to be in any sector.
- **Small and high-growth businesses (SHB)** are small businesses with more than 20% growth in annual turnover. They retain an average of 8.0 full-time employees and are more likely than small and growing businesses to employ more than ten. The clear majority (>90%) are in retail and services.
- **Moderate-growth businesses (MGB)** are medium-sized (20 to 100 employees) with 0-20% growth in annual turnover. In Lao PDR, such businesses employ an average of 32.4 full-time employees, though the clear majority (83%) employ less than 50. Almost none of them are in retail.
- **Gazelles (GAZ)** are high-growth (more than 20% growth of annual turnover), medium-sized businesses. They employ an average of 40.1 full-time employees and usually (59%) have less than 50. They are far more likely to be located in Vientiane than elsewhere. Due to the small number of Gazelles, sectoral breakdown is not reliable.

Two tables below capture some noticeable differences between SMEs and larger firms (Figure 8), as well as more successful higher-growth businesses and the majority of SMEs, which are NEs (Figure 9). Across all segments, differences between male and female-owned SMEs are negligible.

Figure 8: SMEs' properties in Lao PDR compared to large businesses

MORE LIKELY TO BE	LESS LIKELY TO
Female owned	Have internationally-recognised certification
Female managed	Use email and have their own website
Sole proprietorships	Export
100% domestically owned	Have introduced new products/services in last three years
In retail	Provide formal training for employees
In retail	Have financial statements externally checked/certified

Source: EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

Figure 9: SGBs and HGBs in Lao PDR compared to NEs

MORE LIKELY TO
Have more than 10 full-time employees
Use email and have their own website
Have financial statements that are externally checked/certified
Have spent on R&D in the last three years
Be in manufacturing

Source: EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

4. Lao PDR's Entrepreneurial Ecosystem

Lao PDR entrepreneurs face many challenges within the heavily regulated yet highly informal economy, which is dominated by natural resources. The issues affect entrepreneurs regardless whether they have been operating traditional SMEs for many years or are just forming a startup. A coherent entrepreneurial ecosystem has been largely absent in the past, but efforts from both the private and public sectors are starting to develop the ecosystem, now that the importance of a competitive domestic and international economy is increasingly recognized. That said, significant challenges and opportunities for improvement remain.

An analysis of economic constraints by sub-segment reported by WBES-surveyed SMEs is in Figure 10.

Figure 10: Analysis of SME self-reported constraints by sub-segment (WBES 2016)⁶

CONSTRAINT	NE	SNE	SGB	SHG	MGB	GAZ
Practices of competitors in the informal sector	33%	28%	4%	6%	31%	18%
Inadequately educated workforce	15%	4%	0%	10%	23%	58%
Tax rates	20%	30%	4%	35%	3%	0%
Electricity	12%	13%	16%	17%	29%	0%
Access to finance	3%	7%	19%	8%	0%	24%
Transport	1%	11%	0%	4%	10%	0%

Note: Businesses were asked which from the list provided was their biggest constraint.

We have ranked the constraints here according to the frequency with which they were cited across the subsegments.

This report will discuss each of the nine pillars of the ecosystem as per the extended ANDE framework. The following sections will give brief descriptions of entrepreneurs' capabilities, infrastructure, policy, market, human capital, culture, and R&D. More detail is provided in deep dives into finance and business support, which constitute the factors that influence entrepreneurs directly, whereas enabling environment factors have an indirect effect across the board.

4.1 Enabling Environment Infrastructure

Lao PDR's landlocked and mountainous terrain still lacks developed transport infrastructure. This makes it difficult for SMEs in rural areas to access markets and services. It also negatively impacts SMEs that export, or rely on imported production inputs, due to difficult transit routes between seaports in Thailand and Vietnam. In the WBES, 23% of SMEs cited transportation as a major constraint⁸. In the coming years, Lao PDR is expected to receive significant investment in road and rail infrastructure as part of China's Belt and Road Initiative. This may alleviate some of the constraints and bring opportunities for new businesses, as the Lao government pursues its objective of becoming "land-linked".

Despite Lao PDR's strong potential for hydropower, large parts of the country still do not have access to affordable and reliable electricity. The country is often referred to as the "battery of Asia", but a large portion of generated electricity is exported to Thailand. Access to reliable electricity is the second-most reported constraint among SMEs in the WBES⁹: 25% of small and 9% of medium enterprises reported electricity as a major or severe constraint. As such, many of these businesses need to invest in generators to deal with this issue, with 12% of SMEs owning a generator and more than 90% of those obtaining more than a third of their power from it.

Like other countries in the region, Lao PDR has largely leapfrogged fixed line telephones and quickly embraced mobile phones. Currently, there are 128 mobile subscriptions per 100 people¹⁰ – as many subscribers own numbers with multiple networks – and many accessing the internet exclusively on their mobile device. As of December 2017, Lao PDR had 2,439,106 internet users, (35.0% penetration), and 2,200,000 Facebook subscribers (31.6% penetration)¹¹. Fixed broadband subscriptions lag severely, with only 0.1 subscriptions per 100 people. Entrepreneurs that are connected to fixed broadband report significant issues with the speed and reliability of service. This is a major constraint for internet-based SMEs and tech startups, which require stable service to operate, and stable service will require the country to overcome major barriers in the current infrastructure.

Policy

Formalising a business in Lao PDR is notoriously complex and expensive: according to the World Bank¹², it takes 67 days and .5% of annual income per capita¹³. The latter figure was reportedly much higher according to interviewed entrepreneurs and ecosystem stakeholders, likely because line ministry operating licenses and informal fees were excluded.

The three main legal components for registering a business are:

- The enterprise registration certificate from the Ministry of Industry and Commerce (MOIC)
- The tax registration certificate from the Ministry of Finance (MOF)
- Any relevant operating licenses from the competent line ministry

As in many developing countries, the Lao PDR tax system presents major challenges for the private sector, beyond the sheer amount of taxes that businesses pay. These include lack of transparency, uncertain rates, administrative burden or skill gaps in keeping records, and dealing with tax authorities. This further raises the bar for business formalisation, as informal entrepreneurs in all segments are barred from accessing formal means of finance.

⁸ EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank

⁹ Ibid.

¹⁰ World Economic Forum Global Competitiveness Report 2017-2018

¹¹ Internet World Stats

¹² Doing Business, The World Bank (<http://www.doingbusiness.org>)

¹³ Cost is recorded as a percentage of the economy's income per capita. It includes all official fees and fees for legal or professional services if such services are required by law (see www.doingbusiness.org)

Many businesses, including small firms and those at all levels of growth, complain of a general lack of transparency and consistency in the calculation and administration of the major taxes, including value-added, excise, and profit taxes. HGBs in particular claimed this as the biggest constraint in WBES. These inconsistencies are exacerbated by provincial tax officials' different interpretations and requirements. Any support for entrepreneurs to formalise their business must be taken with an understanding of why those problems persist.

If the tax department were to issue comprehensive tax guidelines that clearly dictate procedures for all businesses, officials feel they run the risk of inadvertently creating loopholes with large consequences for tax revenue. For fear of "missing something", the tax department finds it safer to negotiate on a case-by-case basis rather than by laying out comprehensive tax guidelines. Additionally, tax officials prefer negotiating lump-sum taxes because it gives them more discretion and hence enhances their ability to extract informal payments.¹⁴

Some businesses similarly prefer the government's negotiated approach because it reduces the administrative burden of maintaining accurate records for taxation purposes. This preference often applies when the entrepreneurs possess the skills and connections to negotiate a tax liability below what they would pay under strict interpretation of the tax laws.

The GoL recognises these issues and has begun to implement a reform agenda aimed at improving the ease of doing business. An online business database piloted in Vientiane Capital has yet to be fully implemented; however, the GoL is making efforts to reform and simplify the registration process, with support from the World Bank and the Australian Government.

To support SMEs in particular, the GoL has put in place a 2016-2020 SME Development Plan, under the responsibility of the Department of SME Promotion (DoSMEP). It has seven pillars:

- 1. Increase productivity, technology and innovation promotion** strengthen IP protection, provide certificates for innovative firms, create matching grants for innovation investments.
- 2. Access to funding** improve entrepreneurs' financial literacy, simplify bank procedures, set up support funds including the "SME Development Fund" as well as credit associations to support entrepreneurs.
- 3. Access to consulting services to develop businesses** provide trainings in business planning, strategy and standards (ISO, GMP, HACCP, etc.), and strengthen education providers in the technology sector.
- 4. Access to markets** create a database of potential export partners and service providers, establish cooperation mechanisms between local SMEs and foreign investors, contribute funds to organizing trade fairs.
- 5. Increase the number of entrepreneurs** raise awareness on entrepreneurship, organise trainings and workshops, include more businesses subjects in schools, and establish incubators in universities.
- 6. Strengthen the business environment** continue to improve regulations, policy and government procedures, and introduce IT systems to improve ease of doing business.
- 7. Tax and customs policy** provide tax incentives to certain types of SMEs, particularly those aligned with government poverty alleviation objectives (e.g. food security), high technology sectors, VAT and profit tax exemptions for startups 1-5 years old, funding to commercial banks to subsidise interest rates on SME loans (5-7 years tenor, 5-10% interest per annum).

While the SME Development Plan and its constituent components is a good initiative that acknowledges some salient issues, it lacks implementation details. Most interviewed entrepreneurs had no knowledge of concrete outcomes from the plan as of yet. The responsible authorities at DoSMEP attributed the relatively slow start of implementation to a lack of resources, principally funding. GIZ has been supporting DoSMEP with capacity building and technical assistance to realise the development plan, but more resources are likely needed, especially at the subnational level.

Some of these reforms are very broad and will take a long time, but the "low-hanging fruit" of simplifying business formalisation procedures – combined with access to finance support – should go a long way in supporting small and high growing business to become larger and creating more Gazelles and medium-sized enterprises in general.

¹⁴ Mekong Business Initiative (2017), Business Formalization in the Lao PDR, March 2017.

Figure 11: CLMV Doing Business ranking (2013-2019)

COUNTRY/YEAR	2013	2015	2017	2018	2019
Cambodia	133	135	131	135	138
Lao PDR	163	148	139	141	154
Myanmar	-	177	170	171	171
Vietnam	99	78	82	68	69

Source: EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

4.2 Markets

With a population of only 6.9 million, Lao PDR has the smallest domestic market in the CLMV region. In addition, its population density is quite low, with 67% of people living in the rural areas¹⁵ and just around 1 million residing in the capital, Vientiane. This limits the potential customer base for SMEs without requiring export, even from the capital city, where most medium-sized businesses are based. The limited size of the market is one of the major reasons for so many small, competing firms being unable to grow.

The country’s position between the two much larger economies of Thailand and Vietnam offers potential export opportunities, if logistics and trade facilitation is improved. The ecosystem has yet to tap that potential: currently, just 3% of SMEs export directly.¹⁶ This could allow smaller firms in agriculture and agri-processing to grow to medium or even large size. In the short term however, businesses in manufacturing face strong competition from cheaper imported Thai products, while much of Lao’s agricultural production flows across its porous borders unprocessed.

Currently, Lao PDR has an overall trade deficit of about 25%, which is largely due to a reliance on imports from Thailand. Its biggest export partner is China, followed by Thailand and Vietnam (see Figure 12).

Figure 12: Lao PDR’s Main Trading Partners and Overall Trade Figures in 2016 (In USD)

COUNTRY	IMPORT VALUE	EXPORT VALUE	DEFICIT / SURPLUS
Total Lao PDR	4,107,068	3,124,169	-982,899
Thailand	2,541,468	977,425	-1,564,043
China	749,167	1,128,300	379,133
Vietnam	412,994	538,066	125,072

Source: ITC TradeMap (2016 latest year available for Vietnam)

Lao PDR acceded to the World Trade Organization (WTO) in 2013, and the nation continues to integrate with the region through the ASEAN Economic Community. As a Least Developed Country (LDC) and Landlocked Developing Country (LLDC), Lao PDR benefits from tariff-free market access to the European Union under the preferential “Everything But Arms” (EBA) scheme. Lao PDR and the United States signed a Trade and Investment Framework Agreement in 2016. Additionally, the following countries also offer LDC-based tariff exemptions to Lao exports: Chile, China, Taiwan, Kyrgyz Republic, Tajikistan, and Thailand¹⁷. In addition, Lao PDR has entered into trade agreements with various countries including Australia, New Zealand, Canada, India, and Japan.

However, for landlocked Lao PDR to reach overseas markets, the country is largely dependent on transit trade, which has been inconsistently implemented by its neighbours.

¹⁵ According to United Nations Population Fund data.

¹⁶ EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

¹⁷ <http://www.export.gov> (Accessed November 2018)

The hospitality and tourism industry is considered by many entrepreneurs as a viable and growing target market, but tourist arrivals actually decreased 9% in 2017, contrary to trends in neighbouring countries. This was largely due to a decline in visitors from neighbouring countries and several western high-end markets.

However, in the longer-term perspective, non-ASEAN travelers – particularly from China and South Korea – have doubled between 2013 and 2017, supported by more intercountry connections and direct flights between Lao PDR and those countries, and buoyed by the government’s tourism marketing campaigns such as “Visit Laos Year 2018”.¹⁸ Small firms could closely follow this trend in order to tap into future growth potential, especially in services and retail.

4.3 Human Capital

A clear and recurrent finding is that shortages of labour and skills are among the biggest constraints for entrepreneurs in Lao PDR. Nearly every interviewee mentioned labour shortage as a major constraint — and often the biggest constraint — on growth for their firm or more generally the private sector. This was confirmed both in WBES data and reinforced as a common point of agreement during the workshop. The constraint is greatest for medium-sized businesses, especially Gazelles, of which 58% reported it as a major constraint.¹⁹

The underlying causes of labour shortages are complex and interrelated, involving challenges with education, productivity, wages and the migration of workers to Thailand.

While shortage of skilled labour is a challenge common throughout the region, Lao PDR also lacks an adequate supply of unskilled labour. This is partly due to an outflow of labour to neighboring Thailand, facilitated by mutually-intelligible languages. Lao labourers are drawn in by significantly higher wages, and pushed out of their own country by seasonal lulls in the rural job market in line with the agricultural calendar. This type of labour shortage particularly affects medium-growth businesses in the manufacturing sector, as well as smaller firms aiming to move into this segment and on the path to becoming Gazelles.

Figure 13: iJobs WorkJoy

ADDRESSING SOFT SKILLS THROUGH TECH

PROBLEM Lao entrepreneurs face a lack of employees with sufficient soft skills for the modern workplace

WHY IT HAPPENS The current educational system does not provide the skills required by many employers

SOLUTION WorkJoy is a labour capacity-building program that provides trainings and human resource development services. It specialises in workplace behaviour and soft skills, such as inter-personal communication, teamwork, and language skills that are necessary skills for the modern world of workplace. The WorkJoy program includes public training courses, in-house courses, customised courses and project-specific courses targeted toward tertiary college and university students, newly graduates, and job seekers. Overall, the program assists employers – including government organisations, NGOs, domestic private companies and international firms – in building their human resource capacity, both in technical and non-technical skills.

The lack of skilled labour is felt the most by Gazelles, as well as SHBs in service and retail sectors. In addition to technical skills, entrepreneurs frequently note a lack of basic soft skills such as teamwork, punctuality, and communication. It will take deep-rooted reform of the education system, buttressed by a long-term vision and sufficient resources to address these issues at a large scale, but effective interventions can be targeted at entrepreneurs in the short term by listening to their specific needs.

¹⁸ World Bank, Safeguarding Economic Stability: Lao PDR Economic Update, June 2018

¹⁹ EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

Figure 14: Human Capital Indicators

INDICATOR	CAMBODIA	LAO PDR	MYANMAR	VIETNAM
% of SMEs with an inadequately educated workforce as a major constraint	16%	22%	8%	8%
Secondary education enrolment rate, gross %	45%	57%	61%	93%
Female lower secondary enrolment rate, gross %	64%	74%	59%	97%
Tertiary education enrolment rate, gross %	16%	5%	16%	31%

Source: Global Competitive Index 2016-2017, UNESCO

The Lao entrepreneurs interviewed for this study and included in the workshop generally acknowledged an overall lack of entrepreneurial capabilities needed to develop their business, from product development to marketing and sales, and human resource management. They generally possess the necessary technical skills – acquired through either their education or work experience in their sector – but are self-taught in other areas of business development. Furthermore, interviewed entrepreneurs indicated this was largely representative of the entire ecosystem.

Entrepreneurs attributed this to a gap in the higher education curriculum, which only teaches one or two subjects related to entrepreneurship. There are also only few books available in Lao language, so entrepreneurs must rely on books in Thai (which is largely compatible with Lao). A lack of English skills further inhibits their ability to learn from online resources such as online courses and videos.

Another issue is that there are very few role models, or successful entrepreneurs with well-known local businesses to learn from, as the Lao economy is dominated by big players in a handful of sectors that often gained foreign investment. Yet, a wave of younger people is showing more interest and enthusiasm for entrepreneurship, particularly in tech-related sectors. They know they need to improve their skills, but often lack the support to do so.

Training courses and workshops catered toward soft skills can be supported by the government, as well as private sector organisations such as the Lao National Chamber of Commerce and Industry (LNCCI). Startups that require more specific technical skills may be able to find these through networking with like-minded entrepreneurs in co-working spaces and events, or encouraging their employees to take online courses and engage in on-the-job training. In an encouraging sign, participants recommended these suggestions at the #CTG Vientiane workshop, also pointing to other countries in the region, principally Vietnam and Thailand, as examples. However, they noted the need for support and resources.

WOMEN ECONOMIC PARTICIPATION

According to the World Economic Forum's Global Gender Gap Report 2017, Lao women are on parity with men in terms of labour force participation, and the country ranks 22nd out of 144 countries in terms of gender equality in economic participation and opportunity – the highest in CLMV. However, as in the entire region, women have lower educational attainment and literacy rates than men. High growth businesses are less likely to be owned by women, who more frequently own and operate smaller businesses in the informal sector, especially in rural areas. However, female management of formalised SMEs is on par with that of males.

Figure 15: World Economic Forum Global Gender Gap Report 2017

	CAMBODIA	LAO PDR	MYANMAR	VIETNAM
Economic participation and opportunity	0.698	0.769	0.754	0.738
Labour force participation	0.878	1.000	0.946	0.920
Wage equality for similar work (survey)	0.730	0.741	–	0.646
Estimated earned income (PPP, US\$)	0.730	0.846	0.688	0.821
Legislators, senior officials and managers	0.447	0.465	0.396	0.348
Professional and technical workers	0.573	0.692	1.000	1.000
Educational attainment	0.921	0.933	0.975	0.972
Literacy rate	0.797	0.738	0.898	0.954
Enrolment in primary education	1.000	0.988	0.989	–
Enrolment in secondary education	0.918	0.972	1.000	–
Enrolment in tertiary education	0.821	0.956	1.000	1.000

Note A score of 1 reflects perfect parity, the closer to 0 the greater the gender gap.

Source: World Economic Forum Global Gender Gap Report 2017.

4.4 Innovation, Research & Development

Research and development (R&D) is perhaps the most nascent pillar of the Lao ecosystem. Only a few SMEs engage in R&D, with 3% overall having invested in R&D in the past three years, according to the WBES.²⁰ This number remains low across all sub-segments, with the exception of MGBs, which reaches 35%, entirely in manufacturing. This, combined with the low level of R&D among Gazelles, is perhaps best explained as an anomaly due to the small sample size.

Figure 16: Human Capital Indicators

COUNTRY	NE	SNE	SGB	SHG	MGB	GAZ
Myanmar	0%	3%	0%	2%	0%	3%
Vietnam	3%	7%	2%	9%	26%	34%
Cambodia	4%	0%	11%	21%	12%	31%
Lao PDR	1%	4%	12%	5%	37%	5%

Source: Global Competitive Index 2016-2017, UNESCO

Figure 17: Proportion of SMEs that introduced a new or improved product or service in last 3 years

COUNTRY	NE	SNE	SGB	SHG	MGB	GAZ
Myanmar	13%	11%	7%	23%	22%	6%
Vietnam	10%	17%	10%	14%	40%	48%
Cambodia	27%	24%	31%	26%	26%	63%
Lao PDR	12%	17%	12%	8%	38%	5%

Source: EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

Copying business models from neighbouring countries – especially Thailand – is a popular way for entrepreneurs to start a new venture. This includes franchises, which enjoy similar levels of popularity in other countries in the Mekong region.

The main issue hindering R&D is entrepreneurs' inability to ensure their findings are protected. Therefore, the government needs to take the first step of creating strong Intellectual Property protection laws and the accompanying regulatory and enforcement frameworks. These are currently still lacking, but groundwork was laid in the SME Promotion Policy. Once these preconditions are in place, it can be expected that the private sector will become more active in this area, particularly in order to compete regionally and globally.

4.5 Entrepreneurial Culture

As a largely rural and agrarian society, the agricultural cycle remains a strong influencing factor on Lao culture. Workers commonly return to their home village during planting and/or harvesting seasons, resulting in seasonal labour shortages in other sectors, especially for medium-sized enterprises that rely on low-skilled labour. But outside the capital, most small firms are in the agriculture or handicraft sectors and therefore rely on this internal migration of labour.

Among urban or relatively wealthy families, entrepreneurship is not a profession that is universally encouraged across generations. Similar to family dynamics in Cambodia, parents push their children toward a university degree and on toward white-collar office jobs at in the government, international NGOs or larger, establish companies. This negatively impacts the incubation of startups that can mature into SGBs or SHBs.

²⁰ Analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

Risk aversion is another cultural factor affecting the birth and sustainability of startups. Although this is common across the Mekong region, Lao PDR scores particularly low on global indices, receiving a score of just 1 out of 100 in the latest Global Entrepreneurship Index (GEI).²¹ Culturally, failure is not seen as a learning experience but rather a shameful incidence that should be hidden or ignored.

However, in recent years, a small group of young people is challenging the status quo and showing interest in entrepreneurship – partly because of regional integration, international exposure through the internet, and students returning from education abroad. If this group is adequately supported by the ecosystem, they could shape a new wave of Lao entrepreneurs, precipitating a future increase in the numbers of high growth businesses and ultimately gazelles.

5. Finance

According to 2018 World Bank Doing Business data, Lao PDR ranks 77th out of 190 economies on the ease of getting credit. The latest rankings indicate a slight drop after previous improvements in 2016, achieved with the introduction and strengthening of the online collateral registry that currently accounts for 11% of the adult population. This ranking has remained stagnant since, which may indicate that its effectiveness has reached a certain threshold and does not benefit the small and growing businesses that lack assets that can be used for collateral. There is currently no credit bureau in the country, so creation of one would be a logical next step to improve this rating from a policy perspective.

5.1 Credit

One of the biggest challenges to credit in Lao PDR is the disconnect between lenders and borrowers. Many SMEs transact almost exclusively in cash and fail to maintain reliable financial statements. This makes it very difficult for banks to understand a firm's profitability, cash flows, and ability to meet loan repayments. Some banks are highly reluctant to lend to SMEs because of the lack of accurate and reliable information necessary to evaluate the risk of default.²²

Furthermore, most SMEs in Lao PDR are not formally registered, and therefore cannot access formal credit in the name of their business venture. Owners of such businesses may be able to take out personal loans to support their business operations, but they are required to provide their personal land or buildings as collateral, which many are unwilling or unable to do. As a result, informal SMEs lack the ability to invest, grow, and achieve the scale necessary to become competitive.

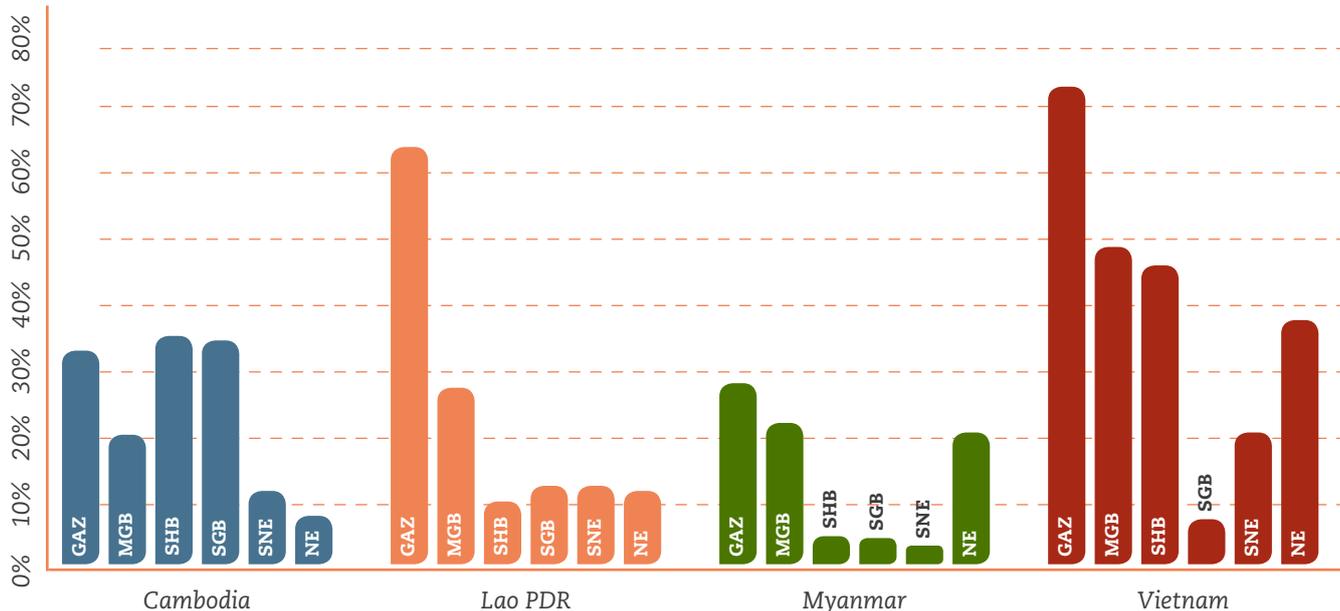
According to the World Bank's Doing Business 2018, Lao PDR ranks 97th out of 190 countries for ease of enforcing contracts, with the average time to enforce a contract being 443 days and costing 32% of a claim value – a situation that has remained unchanged for years. Most financial institutions do not resort to the judicial system to resolve commercial disputes because seizing assets in this way can take up to five years, so many attempt direct negotiation instead.

At the beginning of 2018, the banking sector had 42 banks servicing its comparatively small population, with 101 branches, 510 service units, 37 exchange bureaus and 1,176 ATMs countrywide. However, banking activity is highly concentrated, with three state-owned commercial banks accounting for almost half of all assets in the sector. Each state-owned bank has a specific lending focus: Banque Pour Le Commerce Exterieur Lao (BCEL) concentrates on large corporates, the Agricultural Promotion Bank (APB) focuses on the agriculture sector, and Lao Development Bank (LDB) nominally targets SMEs. But in practice, LDB borrowers tend to be large and medium sized firms, rather than small ones.

²² EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.; Mekong Business Initiative (2017), Business Formalization in the Lao PDR, March 2017.

Generally, very few Lao SMEs have a bank loan or line of credit (Figure 18), and only the larger and/or faster-growing businesses are more likely to have a loan. Three-quarters of Gazelles in Lao PDR have a loan or line of credit. While this is comparatively high among the region, they are also the fewest in number so that fact may skew the frequency.

Figure 18: Businesses with a Bank Loan or Line of Credit



Businesses are much more likely to use bank finance to fund working capital over investment, and generally it is only the larger and/or faster-growing businesses that do so.

Figure 19: Proportion of Businesses Using Banks or NBFIs to Finance - Working Capital

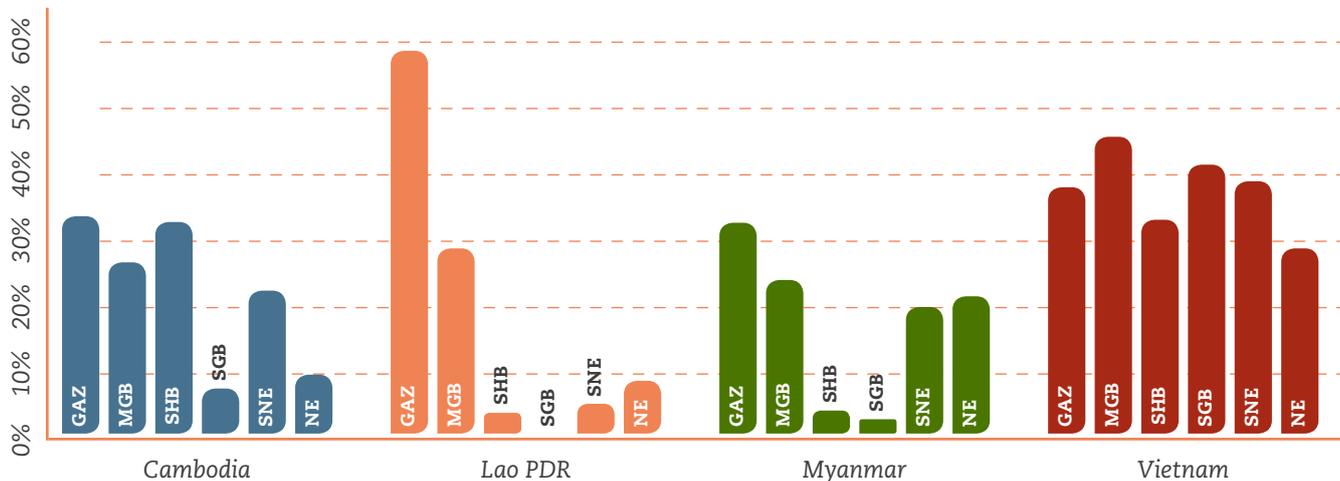
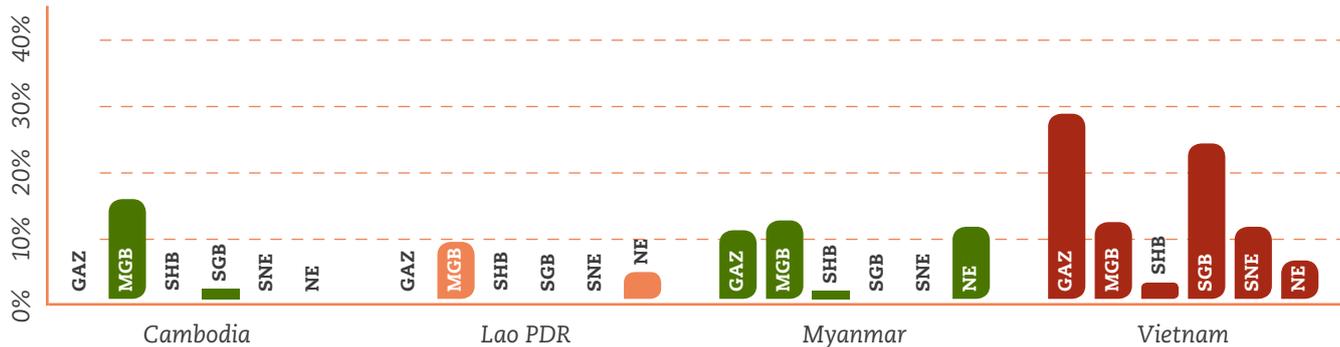


Figure 20: Proportion of Businesses Using Banks or NBFIs to Finance - Investment



Sources EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org/>, The World Bank

Faster growing businesses are more likely to report access to finance as their biggest constraint.

Figure 21: Businesses with a Bank Loan or Line of Credit



Source: EMC analysis based on Enterprise Surveys <http://www.enterprisesurveys.org>, The World Bank.

Many foreign banks and branches do not lend to Lao SMEs, which they perceive as too risky and without proper financials. Instead they merely follow their client bases that migrate to Lao PDR from other countries in the region, such as Vietnam and Thailand. Thus, they do not actively contribute to the entrepreneurial ecosystem.

Local banks are more involved in the ecosystem, with SME lending portfolios that are often supported by concessionary lending from DFIs such as the IFC. For example, ACLEDA Bank Lao is one of the more active private credit lenders serving SMEs, with loans of less than US \$10,000 comprising almost 90% of total active borrowers, and 63% of total loan value as of July 2018. The number of smaller loans has increased significantly in the last few years, indicating a trend of increased lending to SMEs compared to larger firms that require higher tickets.

An added difficulty is the interest spread cap between the deposits and the borrowing rates set by the GoL. This effectively places an artificial cap on the profit margin a bank can make with this funding, which indirectly effects the bank's strategy, its maximum risk-appetite and possibility for pricing risk. In addition to higher risks imposed by SME loans, banks also face higher overhead costs in evaluating, processing, and monitoring a large number of small loans. This higher cost, together with a higher risk of default, causes banks to normally charge higher interest rates. However due to this imposed cap, banks can decide not to finance SMEs at all.

The MFI industry is relatively small in the Lao PDR compared to its banking sector. Despite the large number of licensed institutions (19 deposit taking and 74 non-deposit taking as of end 2017)²³, the sector's total loan portfolio was only about US \$37 million at the end of 2015 (latest data available), with average loan sizes of between US \$200-2,000, depending on the institution²⁴. Part of the reason for this is that MFI loan sizes have historically been capped by regulations, persistently capped at around US \$6,000. More SMEs – particularly the small ones – rely on informal sources of finance as well as small personal loans from banks. Larger SMEs are more likely to meet banks' requirements for business loans.

Some banks – including ACLEDA, ST Bank and Phongsavang – have specific financing products for SMEs, often with donor-backed concessionary finance schemes (see Figure 22). All of them require collateral, which can be immovable (land, house) or movable property, with the exception of credit lines and very small loans, which are sometimes granted based on an evaluation of a business's financial statements. It is also common to receive a "credit line", or personal loan secured against a term deposit with the same bank, in which the entrepreneur essentially borrows his or her own money.

²³ Bank of Lao PDR, Annual Report 2017

²⁴ According to the Lao Microfinance Association

There is a difference in the availability of liquidity among Lao banks: while some have an overhang to keep savings on their balance sheet, others have a loan-to-deposits ratio close to 100%. Without a developed interbank lending system, there are few funding possibilities besides deposits: some banks run into fund shortages and therefore have less loan capital to offer. This constraint creates a waiting list for clients, particularly SMEs, to fund and develop their businesses. Additionally, if a bank decides to borrow from another, there is a gap between their desired loan size and feasible value, due to regulatory restrictions on collateral requirements as well as banks' capacity to assess risk independently. During consultations, several development partners expressed this concern and suggested a need for credit guarantee facilities to support lending to SMEs and put their concessionary financing to work.

Another constraint for banks is that that foreign funds are usually obtained in US dollars, while SMEs are required to borrow in Lao kip. With funding in USD and income in LAK, foreign exchange risk is imposed upon Lao banks. This particularly affects smaller businesses and those targeting the domestic market. The interest rate differential between loans in LAK and USD is also quite significant. This reflects the aforementioned exchange rate challenge as well as the risk perceived in the local currency, especially on loans with longer tenors.

Figure 22: Financial Offerings from Banks in Lao PDR (Currency in USD)

INSTITUTION	PRODUCTS	LOAN SIZE	TENOR	INTEREST RATE	REQUIREMENTS
Phongsavanh Bank	Personal Loan Business Loan SME Pro Loan Large Loan	\$5,000 - \$100,000+ (business loans)	< 1-5 years	LAK: 12-14% USD: 8.5-10.5%	Collateral 80% LTV (proof of salary for personal loan up to \$5,000)
ACLEDA Laos	Business Loan Overdraft Personal Loan Vehicle Loan	< \$5,000 - TBD	< 1-6 years	LAK: 12-13.5% USD: 7-8.5%	Collateral 60-60% LTV Income statements and balance sheet (overdraft)
ST Bank	Personal Loan Micro & Medium Business Loan Overdraft / Credit Line	Depends on ability to service debt and ability to repay	< 1-7 years	LAK: 9-13% USD: 8-10.5%	Collateral 50-50% LTV Borrower assessment; 2 years audited books (for credit line)

Source: EMC summary of financial institutions' websites, annual reports, and interviews

According to WBES data, only 11% of small firms and 26% of medium-sized enterprises had a loan or line of credit from a bank in 2016. The firms reported that loans were overwhelmingly “not needed”, followed by common complaints about complex procedures, collateral requirements, and interest rates. As mentioned previously, informal enterprises were not included in the survey, but these would not have qualified for a loan anyway. Informal enterprises are most likely to be small, which illustrates the impact of the low number for small firms.

In congruence with medium-growth firms constituting the majority of borrowers in Lao PDR, most entrepreneurial lending is for working capital needs, rather than long-term expansion or investment. About 90% of bank lending has a maturity of fewer than three years, which may reflect the perceived risk of lending to businesses in Lao PDR, limitations imposed by the interest spread cap, difficulties in enforcing collateral obligations, and the fact that 80% of bank deposits have a maturity of less than one year²⁵.

Due to the high degree of informality, lack of financial recordkeeping, and minimal collateral, the vast majority of entrepreneurs in Lao PDR are self-financed, as confirmed in interviews with entrepreneurs and ecosystem builders. To access larger loans from banks, entrepreneurs generally must provide collateral and business registration certificates, which is particularly prohibitive for startups and small businesses.

²⁵ Mekong Business Initiative (2017), Business Formalization in the Lao PDR, March 2017.

Early Signs of Change

Interviewed entrepreneurs report that they need formal external financing – especially startup and investment capital for SGBs and working capital for medium-sized businesses. The lack of appropriate financing options, informality, and small domestic market may also explain why so few entrepreneurs in Lao PDR evolve into Gazelles. There are some early signs of change that might ameliorate some of the demand and supply-side constraints in the credit market outlined above:

- A Prime Ministerial Decree signed in June 2018 charges the Ministry of Industry and Commerce with simplifying business registration and formalisation, which will help small businesses seeking compliance. It also urges the Ministry of Planning and Investment to review and introduce laws and regulations that could potentially improve the country's Doing Business ranking. While not explicitly mentioned, measures like creating a credit bureau (following the footsteps of Cambodia) would have this effect.
- Leasing firms are starting to enter the market from other countries in the region, including GL Leasing (Thailand) and KB Kolao Leasing (Republic of Korea). They are currently small but have the potential to fill gaps in the credit market and bring international expertise in order to develop the right products for entrepreneurs and support the government in developing the regulatory environment.
- The Bank of Lao PDR is currently developing a SME Lending Policy, setting up an SME Fund, and is the potential recipient of a proposed US \$300 million SME refinancing line provided by the Chinese Development Bank.

5.2 Risk Capital

The market for equity investments in Lao PDR is virtually nonexistent in every segment. There is no effective network of angel investors and venture capital activity is extremely limited.

Data on individual angel investments is impossible to come by, but several interviewed entrepreneurs reported silent investments and partnerships from family members and well-connected friends. There is no established network of angel investors. The LNCCI is currently seeking to establish such a network, but still lacks institutional capacity. At the end of 2016, the Mekong Angel Investors Network (MAIN) held a pitching event in Vientiane, but investors could not identify any fundable startups and therefore made no investments. This is a clear sign that more work is needed on developing the capacity of the entrepreneurs themselves through incubation and acceleration services.

Worth noting that only two of these businesses are entirely focused on the Lao market, which speaks to the constraint of its relatively small market size on businesses' potential to scale up.

Foreign investment into Lao businesses is also hampered by regulatory restrictions that aim to promote local participation. For example, foreign ownership in 3- to 5-star hotels is capped at 60%, which impacts SMEs potential in one of Lao PDR's biggest sectors, hospitality. Other services such as restaurants, travel agents, and tour guides also require a local participant or joint venture requirement, which puts off some investors. In another example, freight logistics services including road transport, warehousing, and storage do not allow a foreign majority shareholder, limiting those businesses to acquiring just 49% of total shares maximum from foreign investors.

²⁶ Disclosure: EMIA shares the same holding company as Emerging Markets Consulting.

Finally, Lao PDR's capital market is still in its infancy: currently, it's not a viable way for even the largest SMEs to obtain funds. The Lao Securities Exchange (LSX) only lists seven companies, several of which are state-owned enterprises. It is further limited as a source of capital due to the regulation that foreign nationals can only hold a maximum of 1% of the total shares of a single listed company. In addition, the bourse does not have an SME board.

Figure 23: Financial needs of entrepreneurs in Lao PDR

SUB-SEGMENT	KEY CHARACTERISTICS	FINANCIAL CHALLENGES	FINANCIAL NEEDS
Small Growing Businesses <ul style="list-style-type: none"> • 5-19 employees • 10-20% revenue growth 	<ul style="list-style-type: none"> • Small size, medium growth but promising business model • Business owner fulfils most managerial tasks • Many copy-cat businesses in traditional sectors • Often employ friends and family members • US \$5,000-10,000 annual turnover 	<ul style="list-style-type: none"> • Credit secured against personal assets – unregistered • Very unpredictable short term cashflows – revenues concentrated • High risk of business failure – competition, changes in the market, small size • Lack of personal assets (esp. for women) • Lack of access to finance (esp. for women) 	<ul style="list-style-type: none"> • Microfinance • Overdrafts
Small High Growth Businesses <ul style="list-style-type: none"> • 5-19 employees • >=20% revenue growth 	<ul style="list-style-type: none"> • Often successful business models adapted from abroad • Often young, well-educated founders • Predominantly in the emerging but small tech sector • US \$10,000-50,000 annual turnover 	<ul style="list-style-type: none"> • Credit secured against personal assets – unregistered • Very unstable cashflow in the short term – revenues concentrated • Cashflow demand increasing rapidly in medium and long term • High risk of business failure • Challenges assessing credit worthiness 	<ul style="list-style-type: none"> • Short-term working capital • Short-term investment capital • Overdrafts
Medium Growth Businesses <ul style="list-style-type: none"> • 20-99 employees • 1-20% revenue growth 	<ul style="list-style-type: none"> • Steady growth, but vulnerable to economic cycles • Often family businesses, relatively old • Traditional sectors such as hospitality, retail, and agriculture • US \$50,000-500,000 annual turnover (wide range) 	<ul style="list-style-type: none"> • Business lacks enough collateral to secure credit lines • Unstable short term cashflows • Cashflow demand increasing slowly in medium and long term. • Challenges assessing credit worthiness 	<ul style="list-style-type: none"> • Longer term investment capital • Working capital • Trade finance • Leasing
Gazelles <ul style="list-style-type: none"> • 20-99 employees • >= 20% revenue growth 	<ul style="list-style-type: none"> • High growth rates • Respected businesses in the community • Well-connected and often wealthy entrepreneurs • Limited liability firms • Very few in the country 	<ul style="list-style-type: none"> • Business lacks enough collateral to secure credit lines • Unstable short term cashflows • Cashflow demand increasing rapidly in medium and long term • Challenges assessing credit worthiness 	<ul style="list-style-type: none"> • Working capital • Strategic equity investment
Tech Start-ups	<ul style="list-style-type: none"> • Very few, but growing • Resource constrained 	<ul style="list-style-type: none"> • No viable collateral for business loans • Young owners do not have personal assets to secure loans • Small sector, Angels and VCs lack diversification options 	<ul style="list-style-type: none"> • Short-term investment capital • Seed capital

Source: EMC summary of financial institutions' websites, annual reports, and interviews

6. Business Support Services

The entrepreneurial ecosystem in Lao PDR is nascent in many ways, but underdevelopment is most obvious in the lack of business support services for entrepreneurs and SMEs. There are no organisations providing full-fledged incubation, acceleration, and personalised mentoring services. In addition, a paucity of entrepreneurial events and low media coverage have inhibited the development of a vibrant ecosystem. There are some early signs that this is beginning to change, due to the younger generation’s enthusiasm for entrepreneurship.

Currently there are very few entrepreneur hubs in Vientiane (see Figure 25), and none in the rest of the country. The most prominent are Tohlao – which has an additional larger location, Toh-X, where the #ClosingTheGap workshop was held – and the US State Department sponsored Women Entrepreneurial Center (WEC, est. 2017, see Figure 27). Co-working space is limited and there are few places for entrepreneurs to meet and share ideas, although there is potential for growth from companies scaling regionally. For instance, Vietnamese-owned hub operator Toong announced it will enter the Lao market in late 2018, but as of January 2019 had not yet done so.

These hubs generally provide just shared office spaces, with occasional technical trainings organised by private providers. The exception is WEC, which targets only women and mainly traditional vocations. Lao hubs lack the more intensive incubation and acceleration services that regional counterparts provide, such as a network of dedicated mentors, seed capital and opportunities to connect with other entrepreneurs and investors.

These services are traditionally provided by a small group of “ecosystem builders” on an ad-hoc basis for those entrepreneurs who know how to access them. However, these builders are loosely organised, occupied with their own full-time ventures, and therefore not sufficient to carry an emerging new generation of potential entrepreneurs. A more sophisticated hub is therefore needed in order to provide more tailored coaching and networking as requested by interviewed entrepreneurs and #ClosingTheGap workshop participants.

For new entrepreneurs and existing SMEs alike, even more basic skills are still needed. The lack of suitable human resources was identified by both WBES interviews and primary research.

These skill gaps include:

- Knowledge of business formalisation procedures
- Basic financial literacy and business operation skills
- Weak English language skills

Figure 24: Gabiz – Incubation for Social Development

SUPPORT SERVICES FOR RURAL SMES

PROBLEM The rural Lao population lacks business skills and market access, limiting their income potential.

WHY IT HAPPENS Rural areas in Lao PDR are often remote but rich in traditional handicrafts and agricultural products that do not find their way to wider markets.

SOLUTION A partnership between Kabie, Tohlao and Bizgital, GABIZ seeks to connect rural entrepreneurs with larger markets in Vientiane and potentially abroad. They seek out promising businesses and products in rural areas of Lao PDR and support these entrepreneurs with issues such as product design, hygiene and packaging. By giving rural entrepreneurs an understanding of what the markets outside of their villages require, they will be able to sell more and increase their incomes. GABIZ provides its own sales channel for these products, and represents the entrepreneurs at trade promotion fairs and other events such as “Made in Laos 2018”.

Figure 25: Overview of Business Support Providers and Related Stakeholders

GOVERNMENT	DoSMEP
EVENTS	LNCCI, YEAL, MIST
COMMUNITY BUILDERS	TohLao, Gabiz
ASSOCIATIONS	LNCCI, YEAL, Lao ICT Commerce Association
COWORKING SPACE	TohLao, Toong (planned), WEC
MEDIA	108 Magazine

Source: Authors

The largest business association is the LNCCI, which is the main institution for public-private sector dialogue and advocacy. Their projects include the Lao Business Forum, which is the main issue exchange platform between the private sector and government. However, this is generally made up of established businesses, with a large, top-heavy governance structure with two boards and eight presidents, excluding provincial chapters.

Aside from advocacy and organising major events and trade fairs, LNCCI also carries out donor-funded research on the business environment. Currently, it has basic SME promotion services such as its Enterprise Information Center website and SME Service Center, which offers trainings and seminars, but it plans to expand these to include co-working spaces, a mentorship network, and an SME call center, among other services.

To support these efforts, LNCCI has proposed a “2018-2020 Strategic Private Sector Development Plan” with ambitious actions (see Figure 26). These will require the cooperation of many different line ministries, and seeks funding and technical assistance from donors such as the World Bank, GIZ, JICA, ADB, USAID, etc.

Figure 26: LNCCI’s 2018-2020 Strategic Private Sector Development Plan



The Young Entrepreneurs Association of Laos (YEAL) was founded in 2005 as an offshoot of the Laos Youth Union. It is a volunteer-driven, non-profit organisation that aims to support young business owners (defined as younger than 45 years old) by organising short events and workshops for networking and information sharing. Beyond this, it currently offers little direct support to entrepreneurs, especially startups, likely due to the constraints of a volunteer-run organisation. Other business associations also exist at the sectoral level, however these do not serve the needs of all entrepreneurs, and frequently function as a requirement in an otherwise uneven playing field where established businesses dominate. This particularly affects smaller businesses, as medium-sized businesses with lower levels of growth tend to set the agenda of these associations.

Finally, there are the foreign business chambers, representing the major investors from abroad, but these primarily offer networking events that are poorly attended by local entrepreneurs and therefore fail to connect them to foreign expertise. Lack of English language skills as well as general lack of awareness of these events are the primary reasons for this, and affect all but the most advanced entrepreneurs such as the very few Gazelles.

Due to the lack of incubators, accelerators, and other SME-focused associations, entrepreneurship events and workshops are rare – even in Vientiane – and actually seem to decline in frequency. For example, TechStars²⁷ used to hold regular Startup Weekends, but at the time of writing, the last event took place in March 2017, well over a year ago. The lack of such events deprives especially young and aspiring entrepreneurs from the opportunity to network, find partners and share successes and mistakes.

The ecosystem may have previously not been ready for such regular events or generated sufficient interest, but this situation is definitely changing. The #ClosingTheGap workshop in Vientiane was one of the best attended in the Mekong region, with a high turnout of young entrepreneurs who expressed strong interest in attending future entrepreneurship events. Many participants also emphasized a desire to learn from entrepreneurs regionally, especially regarding solutions typically available in other countries that Lao PDR currently lacks.

The infrequent events and minimal media coverage (including social media) results in less interest in entrepreneurship compared to other countries in the region. This is one of the earliest gaps that should be addressed, but it requires a change in mindset. Many currently believe that startups are just ideas that will never become real businesses, remaining informal because those with the ideas and ambition lack support to actualize their goals.

A variety of donors and NGOs have implemented programs including training courses over the years, traditionally with a focus on technical and vocational training (TVET) for poor households. In the eyes of entrepreneurs and ecosystem builders interviewed for this report, previous donor funded programs focused mostly on technical skills, not the entrepreneurial and general business skills required to turn a startup idea into a viable business. They were also not sustainable, and a lack of follow-through resulted in no investment into graduates of such programs.

The latest attempt is the WEC, which does provide some business training in addition to the more traditional weaving, tailoring, and hairdressing courses. If this can be scaled and sustained, it could serve as a model for future programs of this sort.

Early Signs of Change

There are some early signs of change in the entrepreneurial ecosystem. The demand for services is clearly there, as entrepreneurs realise that shortcomings in their own capacities require attention to improve their businesses overall, in addition to being a prerequisite for additional financing and growth. This was reported nearly unanimously through interviews and in the #ClosingTheGap workshop presentations.

Another early success includes the Mekong Innovative Startups in Tourism (MIST) program launched by the Mekong Business Initiative (MBI), which focuses specifically on tourism businesses, in which Lao PDR has relatively high

Figure 27: Women Entrepreneurial Center

SUPPORTING WOMEN DEVELOPING IDEAS INTO STARTUPS

PROBLEM Women are lagging in SME ownership and relegated to traditional gender roles.

WHY IT HAPPENS Lack of support by family and the community.

SOLUTION World Education Laos, through funding from the U.S. Department of State, established the first-ever Women's Entrepreneurial Center (WEC) in Laos in 2017. The WEC's goal is to foster the development of women-owned sustainable small businesses in Laos by providing a space for incubating new business ideas and supporting the growth of existing businesses. Located in Vientiane Capital, the WEC offers in-house trainings on small business management, access to finance, online marketing and basic English for business. The center also provides scholarships to women from throughout Laos to attend extended vocational trainings on tailoring, hairdressing, weaving and natural dyes, accompanied by business training and mentoring. Since training began in February 2018, 100 individuals have accessed the center and 172 received training as of Aug 2018 (some women attended more than one course). It's still too early to assess the impact of the training, and some cohorts – including English and Online Marketing – have not yet started, but overall, participants' reception has been positive.

²⁷ <http://communities.techstars.com/laos/vientiane-laos/startup-weekend/> (Accessed 6 November 2018).

entrepreneurial activity. Three SMEs from Lao PDR – focusing on handicrafts, ethnic tourism, and café businesses – were nominated for the 2017 awards. “Artisan Origins by TAEC”, which provides traditional crafts from rural ethnic communities in Lao PDR, eventually received a US \$7,000 prize in the regional competition. Then in 2018, “BambooLao”, a waste reduction company and social movement led by ethnic communities, took home the US \$10,000 first prize (see Figure 28).

Given the demand and growth of interest in entrepreneurship, as well as a push for more traditional SMEs to formalise, the time appears right for a hub that provides the right portfolio of services to carry this momentum forward. Due to the lack of understanding of the entrepreneurial mindset and knowhow on building an initial idea into a successful business, such a hub should focus on the early stages of the entrepreneurial journey from ideation to launching and expanding upon a minimum viable product.

Figure 28: Showcasing startup success stories as inspiration for aspiring Lao entrepreneurs

BAMBOOLAO: MEKONG INNOVATIVE STARTUPS IN TOURISM (MIST) 2018 CHALLENGE WINNER

PROBLEM Lao entrepreneurs often face lack of recognition for their achievements, and aspiring entrepreneurs lack success stories within their peer group.

WHY IT HAPPENS Lack of awareness and media attention on innovative startups, especially outside the capital, and business associations and events that tend to overemphasise larger enterprises.

SOLUTION MIST is a tourism startup competition supported by the Australian Government and Asian Development Bank that counts Asia's most prominent travel-specialised venture capitalists among its advisors. MIST's top prize comes with a US \$10,000 innovation grant. BambooLao, a Luang Prabang-based social enterprise, beat 111 entrants from across Southeast Asia to take the top prize in the 2018 edition.

“BambooLao is on a mission to eliminate single-use plastics from hotels and resorts across Asia. They have produced more than 80,000 reusable bamboo straws and other bamboo utensils, using indigenous bamboo varieties and a proprietary natural treatment process. Their straws are used by Aman Group, Pullman, Rosewood Group, and Sofitel properties, as well as EXO Travel tours. BambooLao estimates their environmentally-friendly products have displaced the use of 5 million single-use plastic straws.”

Sources: mist.asia; Laotian Times (2018)

7. Ecosystem SWOT Analysis

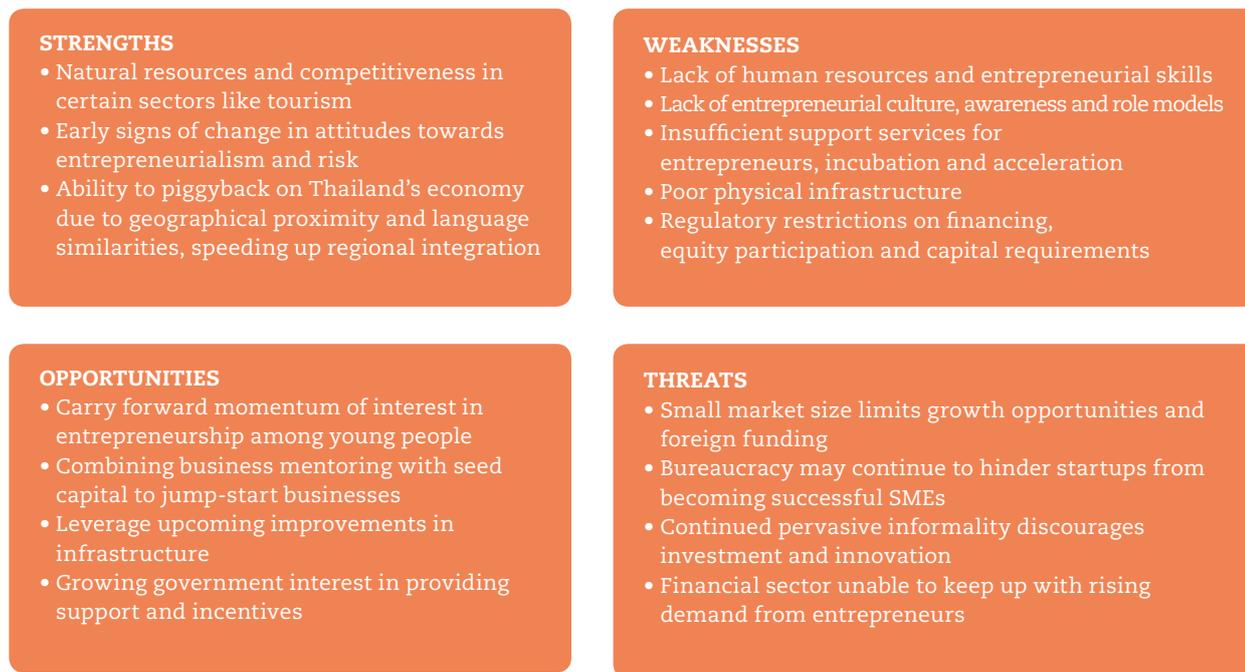
The entrepreneurial ecosystem of Lao PDR is the least developed of all CLMV countries, and lessons for strengthening this environment can be drawn from neighboring economies, particularly Vietnam (the most advanced) and Cambodia (culturally and developmentally the most similar).

The distinct lack of service providers strengthening entrepreneurial capabilities, and helping startups grow from ideas to execution is the main constraint, coupled with a lack of available human resources both at the high and low skilled levels. The latter is quite unique to Lao PDR, and will need to need addressed first before financiers will be able to join the ecosystem in earnest.

Ideally, human resource constraints will be addressed in tandem with early-stage finance mechanisms, such as acceleration services and seed capital. This can start at a small scale, while the Lao ecosystem as a whole catches up to its neighbours.

Another important aspect to consider is Lao PDR's landlocked and small market, which could be at the cusp of transformation due to regional integration. The below SWOT analysis of the ecosystem summarises these considerations and provides a high-level analysis to guide ecosystem strengthening interventions.

Figure 29: SWOT Analysis of the Entrepreneurial Ecosystem in Lao PDR



Source:EMC Analysis

While access to finance is a major constraint for those SMEs with readily executable business plans, proven concepts, and adequately compliant financials, most entrepreneurs are not there yet. The ecosystem first and foremost lacks basic support services to get SMEs formalised and integrated into the national and regional economies. At the macro level, the education system needs improvement, and the business climate streamlined to be less bureaucratic and provide more incentives for innovation.

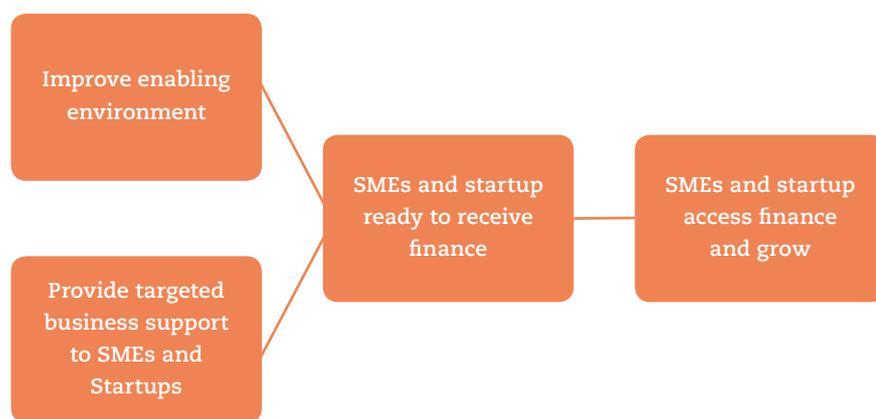
Once human resource and basic infrastructure constraints are addressed, quenching the drought of finance is the next logical step in developing the ecosystem. Depending on how the policy and regulatory environment evolves, this will come from debt financing, angel and venture capital, or mezzanine financing. With the upcoming investments of China’s Belt and Road Initiative, and continued regional integration, it is impossible to separate this from developments in Lao PDR’s major trade and investment partners: China, Vietnam, and Thailand.

8. Way Forward

As highlighted in this report, the prevailing feature of Lao PDR’s entrepreneur ecosystem is that most SMEs are small and growing at low to moderate rates. Compared to the other countries in the Mekong region, its ecosystem is in a very early stage of development. This is substantially due to a weak enabling business environment characterised by a high degree of informality, as well as a lack of business service providers, which in turn produces very few firms able to access formal financing.

There is now an opportunity to jumpstart the Lao ecosystem, via stakeholders’ concerted efforts to reform policy while simultaneously stimulating the right service providers in competitive sectors, especially young entrepreneurs, by providing them with role models and skills to succeed as the ecosystem grows and matures with them (see Figure 30).

Figure 30: Developing the Ecosystem in Lao PDR



Improve the enabling environment for all entrepreneurs, of all sizes

Provide incentives for businesses to formalise and make the process of doing so more streamlined and centralised: for example, a “single window” service for all processes associated with creating a business.²⁸ This mitigates unfair competition from the informal sector, enables businesses to access to formal sources of finance, and will eventually provide the government of Lao PDR with revenues to implement other reforms that improve public service delivery (e.g. the education system).

Capacity building of the government agencies responsible for implementing the SME Development Policy is sorely needed. SMEs report that policies are often either not implemented at all or enforced inconsistently, depending on the location (especially different provinces) or officials in charge.

The education system needs reform, incorporating more entrepreneurship as well as in-demand skills into the school curriculum from the early grades. Technical and vocational training should better targeted to the needs of firms. This will become increasingly important in the context of the fourth industrial revolution, which enables new business models and regional integration but simultaneously puts unskilled workers at risk²⁹.

Regional integration offers an opportunity for Lao entrepreneurs to overcome the limited size of their domestic market. Transport and trade facilitation efforts currently underway by the government and development partners should be continued and accelerated in order to give Lao SMEs access to these markets. Small and medium growth businesses will also need help promoting Lao PDR’s overall brand, as well as more basic support, such as trade fairs where SMEs can connect with international buyers.

Encourage an entrepreneurial culture with awareness and basic services

As discussed previously in this report, the Lao ecosystem is characterised by a lack of service providers, even at the basic level, especially compared to other countries in the Mekong region. Interviewed entrepreneurs asked for and should be provided with more events and workshops, giving them opportunities to network, learn from each other, and create an entrepreneurial community, especially for young startups and the small business segments. This allows entrepreneurs to learn from success stories and follow in the footsteps of ‘champions’ (see e.g. Figure 28), creating more of these in the process and bootstrapping the ecosystem.

Such activities should be implemented through supporting an existing ‘hub’, or establishing a new one, with the aim of providing a more comprehensive set of services. This includes accelerator programs and seed capital for startups, as well as mentoring and coaching for small and medium sized businesses. The overwhelming sentiment among current ecosystem builders and entrepreneurs is that now is the time to start a ‘hub’ with a comprehensive service offering.

The mentoring and coaching needs of each sub-segment are different and should be tailored as such. Startups and small businesses, regardless of growth level, will likely need help formalising, navigating the government bureaucracy and

²⁸ For a more detailed analysis of informality in Lao PDR and associated policy recommendations see <http://documents.worldbank.org/curated/en/979281509632059588/pdf/120867-WP-PUBLIC-Informal-Competition-in-Lao-PDR.pdf>

²⁹ ILO, ASEAN in Transformation: How Technology is Changing Jobs and Enterprises, July 2016

developing basic accounting skills. These relatively basic services can be provided by ‘hub’ staff, as well as peer-to-peer training, to make enterprises more sustainable as the ecosystem develops from its current nascent stage. High growth businesses face separate expansion related challenges: formulating strategy, acquiring growth finance, attracting and retaining qualified human capital, scaling operations and accessing growth markets. This will require more industry or domain specific expertise, which may be brought in through partnerships with the region’s entrepreneurial ecosystems.

Tailor financial offerings for SMEs, from startups to Gazelles

Despite a perceived lack of SME lending products, limited finance in Lao PDR is principally a demand problem, due to the dearth of formal, solid, credit-worthy enterprises to which financial institutions can comfortably lend. If this underlying issue is not addressed, it will be difficult for the overall ecosystem to develop and help entrepreneurs succeed, even when additional guarantee funds, credit lines or investment funds are established.

Therefore, finance-related interventions need to stimulate demand and supply: encourage banks to lend, investors to invest, while supporting SMEs to improve their financial recordkeeping and robustness.

The development of a domestic investment community – with ample seed funding and angel investment – would provide firms with incentives to formalise. Building upon the existing informal networks of potential angel investors, more formal structures can be established to improve access for entrepreneurs who would otherwise not discover the opportunity. Such awareness should be raised through business plan and pitch competitions, ‘hackathons’ and similar support for budding entrepreneurs, with financial incentives to boost and reward participation. The recent success of a small number of Lao entrepreneurs in regional fora should also be more publicised, in order to elevate the entrepreneurial culture and encourage more founders.

In terms of equity and convertible debt, there are currently very limited offerings. Startups need seed capital to complement their own investments in their ventures, but this needs to be coupled with an appropriate accelerator program (see Section 6). A more formalised network of angel investors would help small and growing businesses, as well as high-growth businesses, and a prime objective of any accelerator program should be to prepare businesses to receive angel investment.

Medium-sized businesses – particularly Gazelles and SHBs transitioning into medium-sized businesses – will need to attract the attention of larger private equity investment funds. However, given the low levels of activity in this space, it is unlikely investors can be incentivised to enter Lao PDR within the next few years, particularly because there are eye-catching opportunities in more mature ASEAN markets. Impact investors might be coaxed to support more socially minded businesses, but the ecosystem needs to raise awareness in order to bring Lao PDR out from the shadow of its more advanced regional peers.

For most Lao SMEs across all sub-segments, banks are the main provider of finance. Collateral requirements and complex procedures have been reported as the biggest constraints to SME lending, so these issues should be addressed. Expanding the existing online asset registry into a fully-fledged credit bureau – for individuals as well as businesses – would give a major boost in transparency. This may remedy the complex lending procedures, making it easier for banks to lend, especially smaller amounts at lower risk and cost, therefore addressing supply gaps particularly for small growing businesses and startups.

Medium-growth businesses and Gazelles report requiring financing to invest in productive assets and upgrade capacity and productivity (e.g. modern equipment), as well as working capital to scale up to larger orders in export markets. This could be achieved through targeted support like credit guarantee insurance and banks empowered to provide longer loan tenors.

For any support initiative to develop the entrepreneurial ecosystem to sustainable, working with financial institutions that have specific experience and strategies for SME lending is imperative, as well as alignment with the Government of Lao PDR’s existing and planned SME finance initiatives.

Summary

In summary, the entrepreneurial ecosystem in Lao PDR depends on broad-based improvements to the overall business environment, some of which are already underway via new policy initiatives. This will affect SMEs in all sub-segments and sectors discussed throughout this report, and they should be carried through. Additionally, more specific interventions related to entrepreneurial culture and building support systems for entrepreneurs can impact on even relatively small SMEs and stimulate their growth. The most ambitious entrepreneurs will also need to look beyond Lao PDR’s relatively small domestic market and develop service offerings that can be sold in foreign markets – either through direct exports or regional collaboration with other firms. Fast growing and larger SMEs with more internal capacity are more likely to benefit from a wider and more flexible selection of financial offerings, which would make continued growth possible and therefore allow them to emerge from the missing middle successfully.

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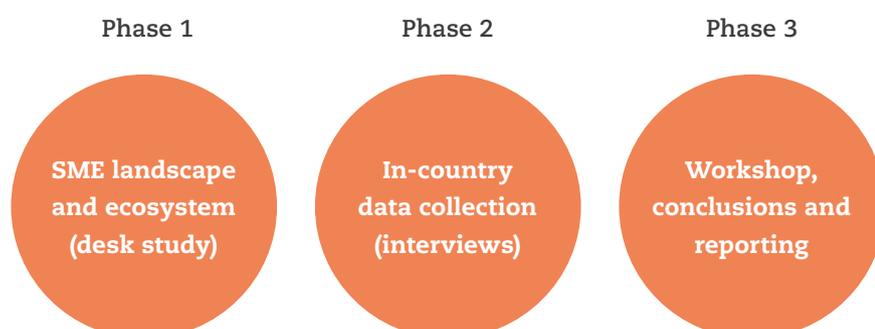
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³⁶ This report was prepared by Emerging Markets Consulting.

Annex 2: Notes on Methodology

The aim of the project is to understand SMEs, the entrepreneurial ecosystem in which they operate, and financing and support offerings, needs and gaps. SMEs are often addressed as a homogenous group. But in reality, they vary widely. It is important to understand the differences among SMEs. Hence our approach includes sub-segmenting SMEs for each country. This allows us to deepen the analysis, identify key challenges for each sub-segment, and to better tailor and target solutions.

The studies were implemented in three phases:



The desk study included a review of existing literature and analysis of data. As requested by DGGF, a major focus was utilising the World Bank’s Enterprise Survey (WBES) data for each country. Other data sources that helped describe the entrepreneurial ecosystem were also used. The WBES and these other sources are discussed in more detail below.

World Bank Enterprise Survey sample

DGGF recommended that the World Bank Enterprise Survey (WBES) would form an integral part of the #CTG analysis. WBES data covers 148 countries (139 of which use the same methodology), including all countries in the #CTG Mekong, and therefore provides good basis for inter-country comparisons.

Generally, the WBES surveys registered businesses with five or more employees. An exception is Myanmar, where smaller businesses (“micro”) were also included.³⁰

The following data summarises the full WBES sample for each #CTG Mekong country.

PROGRAMME	CAMBODIA	LAO PDR	MYANMAR	VIETNAM
Sample size	373	368	607	996
% of sample that is:				
Micro	0%	0%	6%	6%
Small	52%	59%	54%	30%
Medium	31%	28%	27%	40%
Large	17%	13%	14%	30%
Manufacturing	35%	30%	60%	69%
Retail	32%	29%	15%	6%
Services, non-retail	33%	41%	25%	25%
Woman ownership	41%	36%	29%	44%
Woman-managed	53%	38%	29%	22%
Registered	98%	99%	100%	100%
Exporter	9%	9%	9%	21%
- small	6%	1%	1%	7%
- medium	8%	16%	9%	13%
- large	19%	28%	40%	41%
Foreign-owned	10%	13%	5%	9%
- small	3%	6%	1%	2%
- medium	5%	19%	1%	4%
- large	39%	30%	27%	23%
State ownership	0%	2%	0%	4%

Source: World Bank Enterprise Surveys.

³⁰ Although the number of micro businesses surveyed in Myanmar was quite small (see table).

The methodology for the WBES can be found here: <http://www.enterprisesurveys.org/methodology>

WBES coverage

In the WBES the population is the non-agricultural economy. It comprises manufacturing, construction, wholesale, retail, hotels, IT, transport, storage, and communications. It excludes:

- Financial intermediation
- Real estate
- All public administration
- Mining and quarrying
- Utilities
- Professional services (legal, accounting, consulting, advertising, etc.)
- Education (including private)
- Health and social work (including private)
- Hairdressing and other beauty treatment

Businesses with 100% state ownership are also excluded. In each country, businesses in the cities/regions of major economic activity are interviewed.

Stratified sampling and weights

The WBES uses stratified random sampling³¹ when building up its survey sample. This helps ensure the final total sample is not concentrated in one or two industries, for example. Or if only a few large businesses were interviewed (reflecting their share of the total number of businesses), those chosen might not be representative of large businesses. Stratified sampling avoids this. Three strata are used in the WBES: industry, establishment size, and location. For the #CTG Mekong countries, the industry strata are: manufacturing, retail, and services. The establishment size strata are: small (5 to 19 employees), medium (20 to 99 employees), and large (100 or more employees). The location stratification varies by country, but is typically the four or five regions where most businesses operate. So, for example, large businesses make up 17% of the Cambodia WBES sample, even though they account for a much smaller percentage of total businesses in Cambodia.

Since the sampling design was stratified and employed differential sampling, individual observations must therefore be properly weighted when making inferences about the population. Under stratified random sampling, unweighted estimates are biased (unless sample sizes are proportional to the size of each stratum). Any estimate or indicator that aims at describing some feature of the population should consider that individual observations may not represent equal shares of the population. The WBES dataset provides three weights (strict, median, weak) for each observation³². All data in the reports derived by EMC are estimates for the total population using WBES median weights³³.

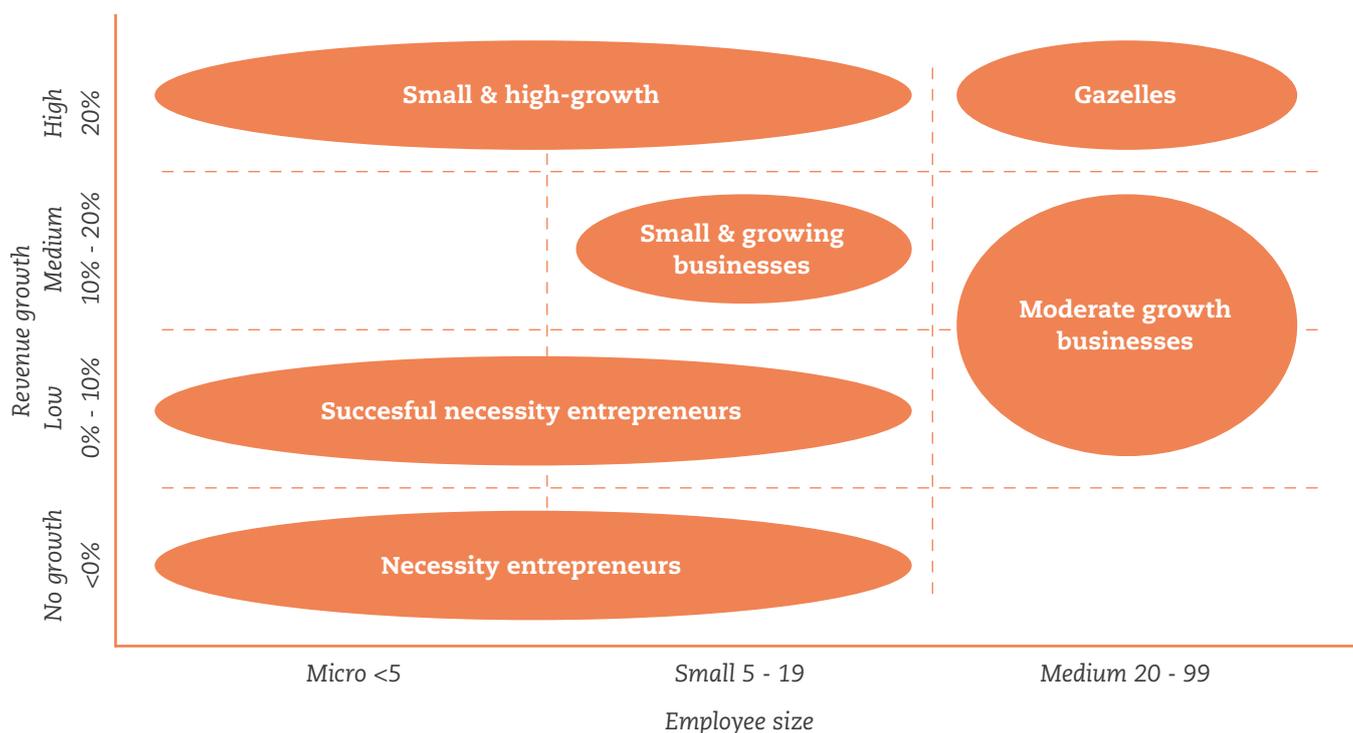
³¹ A stratified random sample is one obtained by separating the population elements into non-overlapping groups, called strata, and then selecting a simple random sample from each stratum.

³² WBES Implementation Reports include more information on sampling and weighting.

³³ Data published on the Enterprise Surveys website is also based on median weights.

SME segmentation

For segmenting the SMEs using WBES data, we followed the approach of #CTG Kenya, using the same nomenclature for the business categories, see the below illustration:



WBES Issues

- Unregistered businesses and micro businesses are excluded. These make up a significant proportion of the private sector in the #CTG Mekong countries.
- Sample size is not large, especially once segmented. Therefore, we need to be mindful of this when discussing sub-segments.
- Revenue growth data was not provided by many businesses, further reducing the sample for segmentation.
- Segmenting by revenue growth excludes young businesses; WBES provides revenue for latest year and 3 years ago, so businesses younger than 3 years are excluded by our segmentation. However, there were very few start-ups and early-stage businesses in the WBES samples for the #CTG Mekong countries.
- Entrepreneur age is not included in WBES, and therefore it is not possible to segment firms by age of their owner or top manager.
- WBES counts establishments, not enterprises. One enterprise (firm) can have multiple establishments (for example, a head office plus a depot). Although for the #CTG Mekong countries the majority of the WBES samples were single-establishment enterprises; Cambodia 93%, Lao PDR 91%, Myanmar 74%, Vietnam 92%.
- As with all business surveys, there can be data quality issues. For example, the reliability of small businesses accurately recalling/reporting sale revenue from 3 years ago. In undertaking the WBES, businesses were re-contacted to clarify answers where necessary.

Entrepreneurial ecosystem analysis

The framework for analysing the entrepreneurial ecosystem was the ANDE³⁴ Entrepreneurial Ecosystem Diagnostic Toolkit. The first study for the DGGF #ClosingTheGap series piloted in Kenya applied a version of this Toolkit. The framework was modified slightly for #ClosingTheGap Mekong by adding entrepreneurs' capabilities at the centre of it.

³ Published by the Aspen Network of Development Entrepreneurs (ANDE), December 2013.

Data for ANDE themes

The WBES provides data for most of the ANDE themes and was used in the reports where possible. The WBES is particularly useful for Finance, Human Capital, Policy, Infrastructure and R&D/Innovation. Other sources also provide data closely related to the ANDE themes, including the Global Entrepreneurship Monitor, the Global Entrepreneurship Index and the Global Competitiveness Index. These were used selectively through the reports. However, some of these sources don't cover all #CTG Mekong countries.



Hence, in addition to WBES, other secondary data sources were reviewed, and these include:

- Infrastructure: Logistics Performance Index; GSMA Mobile Connectivity Index; countryspecific data
- Human Capital: Global Competitiveness Index; UNESCO; World Bank Human Capital Project; WEF Global Gender Gap indicators
- Entrepreneurial Culture: Global Entrepreneurship Monitor; Hofstede Uncertainty Avoidance Index; country-specific data
- Markets: Global Competitiveness Index; World Bank trade data; country-specific data
- Policy: World Bank Doing Business; Global Competitiveness Index; country-specific data
- R&D and innovation: Global Innovation Index; country-specific data
- Finance: country-specific data, local sources
- Support: local sources

The insights from analyzing the above data were then supplemented with key informant interviews in Phase two of the research.

Workshops

#CTG Workshops brought together entrepreneurs and service providers to review, validate and challenge research findings to date and engage in an interactive session towards elaborating solutions to address gaps identified in the ecosystem.

During #CTGMekong workshops in Lao PDR, Myanmar and Vietnam³⁵, groups were asked to comment on 'entrepreneur personas' that typified businesses and growth challenges faced by firms in each sub-segment, as well as identify gaps and propose solutions. Personas were selected for the main subsegments of interest and then designed to reflect research and key informant interviews. Sample personas used in the Lao PDR workshop are described in the table below. A facilitator focused each group discussion on two key research questions:

- **What support is available in the ecosystem to help this entrepreneur?**
- **What specific solutions and services can improve the ecosystem to help this entrepreneur?**

³⁵ Personas were introduced following the #CTG Cambodia workshop.

TohLao collaborated on arrangements for the #CTG Lao PDR workshop and provided the venue. The EMC Laos team facilitated group-based work with local stakeholders alongside representatives from iAngel Vietnam, who were invited to provide an international perspective.

Conclusions from the workshop and group discussions were captured in the final report.

	BACKGROUND	AMBITIONS	CHALLENGES
GAZELLE	ComfyCoffee is a popular coffee shop and bakery, currently with three locations in Vientiane. Two young founders picked up the idea from abroad, and quickly grew the business with financial support from family as well as retained earnings from over 30% sales growth.	<ul style="list-style-type: none"> • Become the leading local coffeeshop brand for local youth in Lao PDR, expanding nationwide • Expand market share before international brands enter 	<ul style="list-style-type: none"> • Founders have reached limits of their management capacity. Lack of access to growth capital, debt or equity • Challenge attracting and retaining human resources especially outside Vientiane
HIGH GROWTH BUSINESS	YourPage is a small Lao web design company for other SMEs. Founded by a few university graduates with a loan from their families, it currently employs six people and is growing quickly.	<ul style="list-style-type: none"> • Take on larger and more profitable projects for bigger clients 	<ul style="list-style-type: none"> • Limited sales skills of the founders • Lack of skilled human resources • High investment in equipment and infrastructure needed
MODERATE GROWTH BUSINESS	CleanSpace provides reliable and custom cleaning services for homes and offices in Vientiane. The business has been growing slowly but steadily over the years, and currently employs about 50 full-time workers.	<ul style="list-style-type: none"> • Speed up growth, but previous attempts to do so have not succeeded • They are willing to give up some equity to bring in expertise. 	<ul style="list-style-type: none"> • Intense competition from the informal sector • Lack of managerial skills • No networks with potential investors
SMALL GROWING BUSINESS	TradeCraft sells high-quality traditional handicrafts, primarily to tourists from western countries. The current manager took over the family business from her parents, which has little cash reserves and an existing \$1,500 MFI loan.	<ul style="list-style-type: none"> • Grow the business by expanding to multiple locations and distribution channels to increase sales 	<ul style="list-style-type: none"> • Lack of market knowledge and access • Lack of business planning skills • Financing options exhausted
SME GROWTH FUND	Entry Growth Fund is a new Development Finance Institution, just established with funding from the government of Wokondo. The fund's management has been given US \$50 million to spend on a program to strengthen the entrepreneurial ecosystem in Lao PDR. They are currently conducting research to inform the design of this program, and have hired you as consultants.	<ul style="list-style-type: none"> • Bridge the funding gap faced by many entrepreneurs moving into the growth stage of their business • Provide support that complements well with existing service providers already in the ecosystem 	<ul style="list-style-type: none"> • Management isn't entirely sure what support entrepreneurs in Myanmar need the most or how it could be delivered most effectively; but they want to get their program started as quickly as possible